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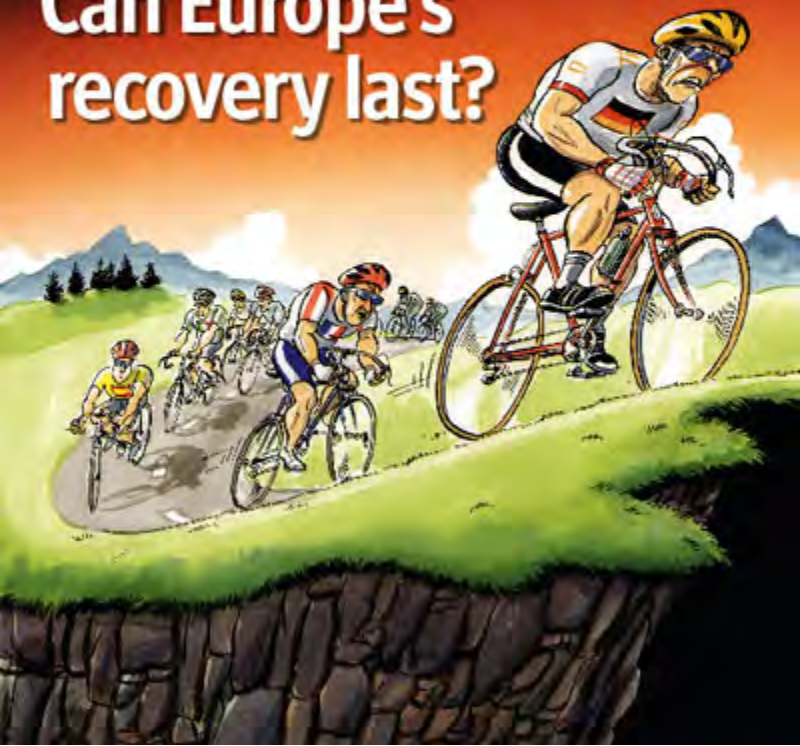

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Politics this week

Jul 12th 2007
From The Economist print edition

AP

As more Republican senators withdrew their support from his policy on Iraq, **George Bush** pleaded for more time and urged people to wait for a progress report in September on the troop "surge". Congress ignored him and began two weeks of debate on an interim progress report. See article

Meanwhile, Mr Bush's **approval rating** dropped to 29%, according to Gallup. Its poll was taken after the president commuted the jail term of Lewis "Scooter" Libby, a former White House aide who was sentenced for perjury. Two-thirds of Americans thought the president should not have intervened in the case, said Gallup (6% wanted him to grant a full pardon).

It was also a bad week for **John McCain**. The Arizona senator's presidential campaign received a serious blow when both of his top aides resigned. Mr McCain, who is trailing his Republican rivals for the party's nomination in opinion polls and fund-raising, vowed to fight on. See article

Florida became the latest state to adopt tough rules on global warming, unveiling a regulation that would reduce **greenhouse-gas emissions** to 80% below their 1990 levels by 2050. New Jersey also adopted a similar law.

The stalemate between **Pennsylvania's** Democratic governor and Republican-controlled Senate over the state budget was resolved following a brief shutdown of some government services. A row over a surcharge on electricity bills to pay for greener energy measures was deferred until the autumn.

Trying to repeat an atrocity

Four **Islamist terrorists** were given life sentences for plotting to explode bombs on London's transport system on July 21st 2005 (two weeks after suicide-bombers killed 56 people). All four men were originally from the Horn of Africa.

The **French president**, Nicolas Sarkozy, attended a meeting of finance ministers from the euro area in Brussels to explain why France might not meet its commitment to eliminate the budget deficit by 2010. Several of those attending the meeting grumbled, but there is little they can do.

European finance ministers endorsed a French candidate, Dominique Strauss-Kahn, to take over from Rodrigo de Rato as head of the **International Monetary Fund**.

Cyprus and **Malta** won approval to join the euro on January 1st 2008. They will become the single currency's 14th and 15th members. See article

Musharraf takes a gamble

AFP

After a week-long siege of the Lal Masjid or Red Mosque in Islamabad, some 200 **Pakistani commandos** stormed the compound and met fierce resistance from militants sheltering inside. Nearly 100 people died in the ensuing battle, including the militants' leader, Abdul Rashid. See article

Prosecutors in **Indonesia** announced a civil suit seeking the recovery of $440m from Suharto, the president who stood down in 1998. They also sought $1.1 billion in damages. In 2000 the government dropped criminal charges after doctors said Mr Suharto was too ill to face them. See article

Zheng Xiaoyu, the former head of **China's** State Food and Drug Administration, was executed for corruption. He had been convicted of accepting bribes to approve medicines. There has been a rash of cases involving tainted Chinese exports, ranging from toothpaste to pet food.

Australia's prime minister, John Howard, termed “provocative and insensitive” the appointment of Julian Moti as the **Solomon Islands'** attorney-general. Mr Moti faces charges of child abuse in Australia, which has a peacekeeping mission in the Solomons.

On the frontlines

One of the most lethal terrorist bombs since the American invasion of **Iraq** four years ago killed at least 160 civilians, including women and children, in a village inhabited by Shia Turkomans north of Baghdad. See article

Representatives of Hamas, the Islamist movement that now controls the Gaza Strip, boycotted an emergency session of the **Palestinian** parliament called by President Mahmoud Abbas, who heads Fatah, the main secular party. Without Hamas's presence, there was no quorum, thus preventing the ratification of the emergency government appointed by Mr Abbas three weeks ago.

A suicide bomber in **Algeria** killed at least ten people in an attack on a barracks, just before the opening of the All Africa Games, one of the continent's big sporting events.

Libya's Supreme Court upheld death sentences imposed in 2004 on five Bulgarian nurses and a Palestinian doctor for allegedly infecting children with HIV. But a mediating body may be near to agreeing on a financial settlement with the children's families, which would mean that they drop their right to demand the death penalty.

In **Ethiopia** a state prosecutor called for the death penalty in the trial of 38 opposition leaders who were found guilty of inciting violent protests that left nearly 200 dead in the wake of flawed elections in 2005. The trial judge will pass sentence in the next few weeks. The United States, Ethiopia's ally in the war against Islamist terrorism in the Horn of Africa, called for leniency. See article

An understatement

In **Colombia**, the FARC guerrillas admitted that they had failed “to care for” 11 hostages killed last month, and said they would turn their bodies over to the International Red Cross. Earlier, hundreds of thousands of Colombians took to the streets in protests against the killings. See article

A small guerrilla group claimed responsibility for bomb attacks that shut down four gas and oil pipelines in **Mexico**, and demanded that the government release three activists arrested in the southern state of Oaxaca in May.

In a surprise decision, a judge in Chile rejected a request by Peru for the extradition of the country's former president, **Alberto Fujimori**, to face corruption and human-rights charges. The case will now go to the Supreme Court. Last month Mr Fujimori had announced plans to stand in a Japanese election in an apparent ruse to escape extradition.

Canada's prime minister, Stephen Harper, said his government would order up to eight ice-breaking corvettes to assert the country's claim to sovereignty over Arctic seaways. See article

Snow fell in **Buenos Aires**, for the first time in 89 years.

EPA

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Business this week

Jul 12th 2007
From The Economist print edition

Investors reacted nervously to more bad news stemming from the slowdown in America's **housing market**. Standard & Poor's and Moody's disclosed that they were downgrading or considering downgrading **credit ratings** on more than $17 billion-worth of bonds backed by **subprime mortgages** (aimed at low-income and poor-credit households) because they had underestimated the level of defaults. Stockmarkets in America and Europe fell sharply and the **dollar** continued its slide, reaching a record low against the euro. See article

Shareholders in both the **Chicago Board of Trade** and **Chicago Mercantile Exchange** voted to support their merger, ending a nine-month effort to create the world's largest derivatives platform.

After weeks of speculation **Rio Tinto**, a global mining giant, formalised a $38.1 billion offer for **Alcan**, an aluminium producer based in Canada. Alcan was open to a deal after Alcoa, its American rival, made a hostile $27 billion bid in May. Alcan's board unanimously recommended Rio's offer, one of the biggest in the booming commodities sector in recent years.

Company digest

Danone, a French food-group which last week sold its biscuits division to Kraft, agreed to buy **Numico**, a Dutch company specialising in baby food and “clinical nutrition” for the elderly and sick, for *euro*12.3 billion ($16.8 billion). Danone maintains that the acquisition will enhance its yogurt and bottled-water divisions (which include the Volvic and Evian brands) as it repositions itself as a leader in the fast-growing health-and-wellness market. Some analysts, however, thought it was paying too much for a business in which it had little experience and viewed Danone's move as a defence against any potential takeover bids.

Google said it would pay $625m for **Postini**, a private firm best known to office workers for its web-based e-mail security and spam-sieving technology. The deal will expand the services available in the Google Apps package tailored to the corporate world, further encroaching on Microsoft's territory.

Nielsen//NetRatings made changes to its gauge of **activity on the internet** by adding the number of minutes spent by browsers at websites to its criteria. The media research company wants to provide a more accurate measure of audience engagement to advertisers, which allocate spending by pages viewed.

Future flight

Boeing unveiled the **787 Dreamliner** in an elaborate ceremony broadcast on TV and the internet. The Dreamliner is Boeing's first new jet in 12 years. It is partly made from light composite material, and so uses 20% less fuel per passenger than similarly sized aeroplanes. The company's order book for the aircraft is full.

The $8.1 billion deal between **General Electric** and **Abbott Laboratories** unravelled. GE said in January it was buying Abbott's lucrative medical-diagnostics division, but the pair couldn't agree on terms.

Sony cut the price of its **PlayStation 3** games console by $100 in America in an effort to boost sales. Sony's device is lagging in popularity behind Microsoft's cheaper **Xbox 360**. Its rival seemed unfazed by the price cut, though it has its own problems. Microsoft said last week that it would take a profit charge of more than $1 billion to cover complaints about a flaw in its console.

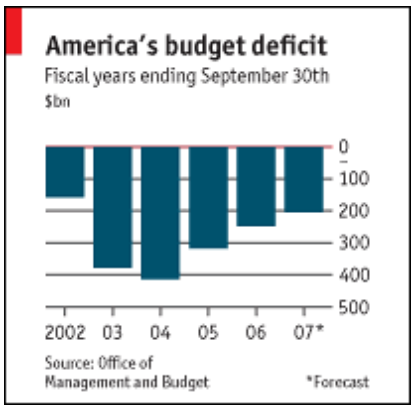
There were signs that Russia is softening its stance towards Western participation in its energy projects. **Gazprom**, the state-controlled gas monopoly, reversed course on allowing foreign firms a stake in the **Shtokman** field (Gazprom rejected five potential partners last autumn). And **Royal Dutch Shell** signed a co-operation pact with **Rosneft**, Russia's state oil company. Shell was pressured into ceding control of an energy project to Gazprom last year, but analysts say Russia is now facing up to the costs of developing

its oil and gas assets alone.

The **International Energy Agency** issued a pessimistic outlook on the supply of oil and natural gas, predicting a “crunch” after 2010 because of slow production among non-OPEC countries. The demand for oil was forecast to rise by 2.2% a year. As a consequence the IEA does not expect much easing of **oil prices**, which hit an 11-month high this week.

The right direction

There was some good news for George Bush. The White House's mid-year **budget review** forecast that because tax revenues were higher than expected during the spring, the government's spending deficit would be $205 billion this fiscal year, $39 billion less than had been thought. Others, including Congress's number-crunchers, predict the actual deficit will be even less when it is made official in October.



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KAL's cartoon

Jul 12th 2007
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Kevin Kallaugher

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European economies

Can Europe's recovery last?

Jul 12th 2007
From The Economist print edition

Only if its governments take advantage of sunnier times to make deeper reforms

Peter Schrank

AS EVERY actor knows, it is easy to be typecast. The role assigned to Europe for the past decade has been that of sclerotic under-achiever: a slow-growing, work-shy and ageing continent that is destined to be left behind by the United States, China and India. Unnoticed by the audience, Europe, under new political leadership first in Germany and Italy and now in France and Britain, has changed the plot. Since the end of 2006 euro-area GDP has outpaced America's: in 2007, it should grow by 2.7%, ahead of both America and Japan. The euro is at new highs against the dollar and the yen. Unemployment has fallen to 7%, the lowest since the euro started life in 1999.

The transformation has been most remarkable in Germany, the biggest European economy, once tarred as “the sick man of Europe”. From 1995 to 2005 German GDP grew at an average of only 1.4% a year. But in the first quarter of 2007 it expanded more than twice as fast, despite a large rise in value-added tax. The 2004 reforms in labour markets and welfare made by the previous government under Gerhard Schröder are bearing fruit. On international definitions, unemployment is down to 6.4%, not much above the level in Britain. German business is doing spectacularly well: the country is again the world's biggest exporter, profits are at a record, competitiveness has improved sharply (see article).

Where Germany leads, the rest of Europe follows. In truth the picture of an entire continent in a slump was always distorted. Several countries in Europe have been doing well for some years. Britain and Spain have grown consistently. Ireland has produced the nearest thing to an economic miracle outside Asia; smaller east European economies are seeking to emulate it. Scandinavia boasts three countries that top most league tables for competitiveness. The truly troubled economies of Europe were always the core euro-area ones: Germany, France and Italy. Now that Germany has picked up speed, the other two are improving too. The new French president, Nicolas Sarkozy, is promising to boost growth. Some Europeans may be tempted to conclude that their economic problems are behind them, their structural faults have been put right—and there is no need for more painful reforms.

The turn of the cycle

Such a conclusion would be wrong on pretty much every count. Yes, there have been structural improvements in the core euro area, especially Germany. But much of the recovery is really cyclical. When the global economy is registering a fourth successive year of near-5% growth, it would be surprising if the world's biggest exporter did not benefit; indeed, growth of 3% seems rather modest. Moreover, much of Germany's renewed vigour reflects stringent control of real wages, which has secured

a fall in unit labour costs when they have been rising elsewhere. Yet merely squeezing pay to gain competitiveness is not a long-term solution.

The gain also comes at the expense of other euro-area countries, such as France, Italy and Spain. This creates tensions of its own, much on display this week when the hyperactive Mr Sarkozy dropped in to a meeting of euro-area finance ministers in Brussels. He announced that France might again flout the euro-area stability pact's restrictions on budget deficits, and repeated his previous complaints about the strength of the euro and the tight monetary policy of the European Central Bank. He ran into a stony hostility, notably from the Dutch but also from the Germans (see article). The French president has similarly been to the fore in attacking European Union competition rules and talking up the causes of industrial policy and economic patriotism.

A myth, Mr Sarkozy, and you know it

The charitable explanation for this nonsense is that laying into Brussels is a way of diverting French voters from the genuine (and long overdue) reforms Mr Sarkozy is planning for the labour market, welfare and taxation. But his agenda seems also to be driven by a common belief in France (and in other parts of Europe) that the euro's macroeconomic management and the obsession in Brussels with pursuing pro-competitive reforms are to blame for the region's economic ills.

This is to get things entirely backwards. As is obvious from the divergent performance of individual countries, the euro area's troubles are not macroeconomic in nature. Rather they are microeconomic, reflecting the failure of several countries to reform rigid labour markets and overly regulated product markets. These countries have been suffering not from too much competition, but from too little: for too long, too many of their workers and producers have been sheltered from competition, fostering high costs and inefficiency.

Nor will partial reforms of the kind so far carried out be sufficient. This can best be seen in the labour market in Germany, which (like Italy's) has been only partly freed up. The result has been not just a welcome explosion of temporary and part-time jobs, but, more insidiously, the entrenchment of a two-tier labour market. Insiders have permanent, protected contracts; outsiders have short-term, unprotected ones. This will fuel resentment among outsiders (often the young or immigrants). It also threatens to introduce new rigidities into the wage-bargaining process, because insiders may feel sufficiently insulated to demand higher pay in the knowledge that any resultant job losses will fall on outsiders.

The unpalatable truth remains that Europe's economies need substantial further reform if they are to prosper in an ever more competitive, globalised environment. And the recent upturn may make it harder for political leaders to get their voters to understand this.

European countries that have introduced radical reforms have usually done so in times of serious economic crisis: Britain in 1979, the Netherlands in 1982, Ireland in 1987, Denmark, Finland and Sweden in the early 1990s. Yet as all these countries found, it is easier to change when times are good, not when they are bad. That is a lesson that Germans, French, Italians and other Europeans should ponder as they bask in today's sunshine.

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The International Monetary Fund

Fait accompli

Jul 12th 2007
From The Economist print edition

The IMF can ill afford another term of hypocrisy

David Simonds

Get article background

THE French were not the happiest of campers at the Bretton Woods resort in New Hampshire, where the International Monetary Fund was first conceived in 1944. Their country had yet to be liberated, and its place in the economic pecking order was uncertain. The French fretted that even the Benelux countries (Belgium, the Netherlands and Luxembourg) might have more collective clout in the new institution.

They need not have worried. The IMF has been kind to their country. France was the first member to draw money from it, and Frenchmen have led the organisation for half of its life. Thanks to an "understanding" reached this week by the European Union's finance ministers, the top man at the IMF looks set, once again, to speak with a French accent.

Dominique Strauss-Kahn, a former finance minister, got the nod to replace Rodrigo de Rato, who surprised everyone by announcing he will resign in October after just three years in the job. Mr Strauss-Kahn is an urbane, multilingual economist, who appreciates liberal principles, even if he did not fight terribly hard for them in the Socialist Party to which he belongs. He resigned as finance minister in 1999, after three years of prosperity, prudence and privatisation, to clear his name in a corruption scandal. He is, in short, the kind of candidate who might win the job on merit. But that is not how the job is filled. By convention—a kind word for a stitch-up—Europe lets America pick the head of the World Bank, and in return, Europe names the head of the IMF. The rest of the fund's 185-strong membership is left to grumble, grouse and go along.

The EU finance ministers said this week they would consider a more open process—but not until next time. Their reasoning was simple. The Americans got to pick one of their own to replace Paul Wolfowitz, ousted from the World Bank in May for personal indiscretions, so why should the Europeans give up their customary privileges first? Thus does the world of economic statesmanship resemble a playground squabble.

After the bruising battle to oust Mr Wolfowitz, it might be argued that the bank needed a capable replacement quickly, and could not afford to open the process up. The fund, however, can ill afford not to. Mr Strauss-Kahn will inherit an institution that risks losing many of its traditional clients. Emerging economies, which once begged for the fund's money and bowed to its ministrations, now have their own hoards of foreign exchange to rely on.

Responsibility without power

The fund aspires instead to be an umpire of currency disputes between its biggest members. It has just won more leeway to scrutinise and criticise exchange-rate policies that it believes are out of whack. If a currency is judged to be a threat to others' stability, the fund will say so. A country like China, the fund feels, now carries so much weight in the world economy, it can no longer pick an exchange rate to suit itself. It must take account of the fall-out on the rest of the world.

But if China is too big to be left to its own devices, then surely it must also be too important to be left out of picking the head of the fund? Mr de Rato seems to understand this. He pushed for China, Mexico, Turkey and South Korea to receive extra votes last September, and wanted a broader redistribution of power this year or next. He also supported a “transparent process” for picking his successor. It now looks as though even that blindingly obvious reform must wait another five years at least. The delay will test the patience of the fund's fastest-growing members. Despite the September reform, China still has less weight than the Benelux countries. The French, of all people, should appreciate the indignity of that.

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After the battle for the Red Mosque

The general and the mullahs

Jul 12th 2007
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To defeat Islamist extremism, Pakistan needs a return to democracy

Reuters

THERE could be no starker illustration of the danger Islamist militancy poses Pakistan; nor any more dramatic demonstration of the government's resolve to combat it. That, at least, is how General Pervez Musharraf, Pakistan's president, would like the world to see this week's bloody end to the siege of the Lal Masjid, or Red Mosque, in Islamabad (see article). Does it not show that he is Pakistan's best bulwark against the rise of a Taliban-style regime in a moderate Muslim country of nearly 170m people? Does it not prove that he is America's indispensable ally in the fight against al-Qaeda and other terrorists?

Yet the general's opponents have a different analysis of the Lal Masjid trauma. They say that it shows how violent extremism has spread its tentacles under General Musharraf's eight-year rule, and how he is not the solution to the problem but its cause. This is a simplification; but it is closer to the truth than the general's own, self-aggrandising version.

The two firebrand mullah brothers running the mosque and the *madrassas* linked to it had, with thousands of followers, resisted the government's writ since January. They sent squads of vigilantes around Islamabad, Pakistan's capital, to enforce their puritanical morality, attacking video shops, kidnapping alleged prostitutes and threatening suicide-bombings should the government use force against them. Eventually, with its patience exhausted, and an important ally, China, infuriated by the kidnapping of a number of Chinese citizens accused of running a brothel, the Pakistani government sent in the army. After a week-long siege came a brutal showdown with zealots seeking martyrdom.

For General Musharraf's supporters, this is par for his seemingly straight-talking course. He has repeatedly risked his job and his life to take on extremism. Within a day of the September 11th attacks on America, he had ditched a long-standing ally, the Taliban regime in Afghanistan, and hitched Pakistan to America's anti-terrorism wagon. He has started to rein in the groups waging *jihad* against Indian rule in part of Kashmir. And he has survived at least three assassination attempts—most recently this month—apparently by jihadist groups. In this analysis, his actions this week fitted this record: unleashing the power of the state to assert the rights of the moderate majority against the extremist fringe.

However, there is a more cynical way of looking at the storming of the mosque. The timing may turn out to be good for General Musharraf. It has reminded the world of the threat of extremism in Pakistan. It has restored the general's image after his rule had been jolted by a nationwide campaign led by lawyers and intellectuals against his attempt to sack the country's chief justice. No longer the butt of the democrats, the general is again the scourge of the militants.

And yet the truth is that General Musharraf has spent his career in an army that has fostered close ties

with extremist Islam. The army exploited the spirit of *jihad* to wage war in the 1980s against Soviet rule in Afghanistan, and then against India in Kashmir. At home the Islamists have also had their uses, being easier to co-opt in times of military dictatorship than the democratic parties. Though less blatant than the previous military ruler, Zia ul-Haq of the 1980s, General Musharraf has made himself a patron of the militants. His henchmen forged the six fractious parties that represented the Islamists into an alliance that enjoyed unprecedented success in elections in 2002. Since then Islamists have tasted power in two of Pakistan's four provinces, North-West Frontier Province and Baluchistan. Formally in opposition to the federal government, they have backed it on contentious constitutional issues. Meanwhile on the margins, where the lawless tribal areas blur into Afghanistan, a Pakistani Taliban has sprouted.

The ticking of the electoral clock

The battle for the Lal Masjid will now become part of a strange kind of election campaign. General Musharraf's term as president expires in October. If he is re-elected (by an electoral college composed of national and provincial legislatures), the constitution requires him to retire from the army at the end of the year. General elections are also due by January at the very latest. But the ruling party would lose a free and fair election. So if the general wants to cling to power (and generals, like other politicians, usually do), he faces four choices: have himself re-elected by the existing college (constitutionally dubious); declare an emergency and postpone elections (looks bad); hold some, and rig them (the usual and probably favoured option); or strike a deal with one or both of the leading civilian politicians in exile, the two former prime ministers—Benazir Bhutto and Nawaz Sharif.

The last of these options would be much the best. It might at last endow Pakistan with a government that has the legitimacy to take on the extremist threat. Pakistan, after all, is not an extremist country: in 2002, despite much help from the government, all the Islamist parties combined still won only 11% of the popular vote. But Pakistan's history suggests that military rule tends to strengthen the extremists. General Musharraf's men are in detailed discussions with Miss Bhutto about how they might divide power between a President Musharraf (who, even out of uniform, would still lead the army and be responsible for defence and foreign affairs) and a Prime Minister Bhutto, responsible for everything else. After a free election, many Pakistanis might settle for that. But a free election is the essential first step.

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Energy policy

A pale shade of green

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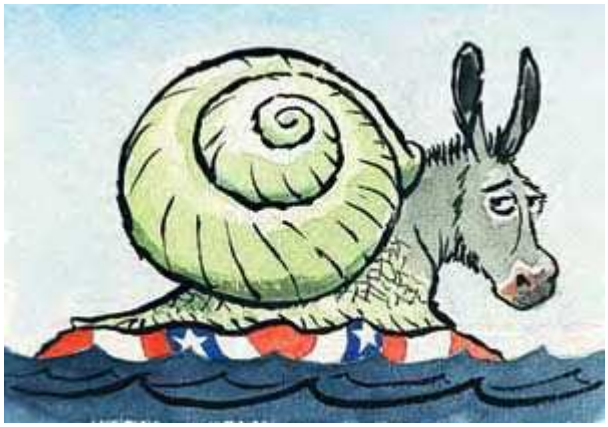
From The Economist print edition

When it comes to climate change, the Democrats are proving almost as bad as George Bush

Claudio Munoz



SOON after the Democrats took control of Congress last year, its new leaders promised to overhaul America's energy policy. They vowed to tackle climate change head-on, despite the president's reluctance. No longer, they said, would they meekly accept America's reliance on foreign despots for imports of oil. And something would be done to lower the price of petrol (gasoline), they assured agitated drivers. Nancy Pelosi, the new speaker of the House of Representatives, set up a special committee to come up with a solution to the nation's energy woes by July 4th, so that America's new political masters could declare “energy independence” on the same day their forebears renounced the colonial yoke.

But July 4th has come and gone, Ms Pelosi as yet has no energy bill and America is still just as firmly yoked to expensive, dirty, imported energy as ever. The price of oil is near the nominal record reached last year, and petrol costs well over $3 a gallon. Not only have the Democrats shelved any plan for limiting greenhouse emissions; they have also embraced two of Mr Bush's more pernicious ideas: using greenery as an excuse to dole out subsidies to ungreen lobbies; and claiming a bogus link between climate change and energy independence.

Give the Senate Democrats credit for one thing: they have passed an energy bill that would require American cars to guzzle a bit less petrol. That is no small achievement. It is the first time either chamber has resolved to raise fuel-economy standards for a third of a century. Sadly, however, the Senate's energy bill weds sensible steps on fuel economy and energy efficiency with all manner of less helpful, populist measures, including new anti-price-gouging rules aimed at big oil companies and hand-outs for farmers in the form of new incentives for expensive (and ungreen) corn-based ethanol. It also empowers the government to sue members of the Organisation of the Petroleum Exporting Countries for forming a cartel—a step that is not likely to increase America's access to oil.

The House has yet to pass a bill, but it will probably include most of this tosh, as well as subsidies for the pet technologies of various congressmen, perhaps including a particularly grubby fuel derived from coal. Even if the House and the Senate can patch a bill together from this mish-mash, the president may yet veto it. And rightly so: in its lack of ambition and its embrace of boondoggles, the prospective bill resembles the generally derided Energy Act which the oil-fired Republicans pushed through in 2005.

The Democrats hold at least two suspect truths to be self-evident. Most obviously, they think that politicians should micro-manage energy policy, encouraging some technologies and neglecting others. That ignores most of the lessons of economics, but it is decidedly well grounded compared with the Democrats' other verity: that slowing global warming and reducing dependence on imported fuels go hand-in-hand. What sense does it make to give preference to American ethanol over the cheaper and

more climate-friendly Brazilian sort? (Indeed, if you embrace the goal of “energy security”, bigger imports of Brazilian ethanol might help, by reducing America's demand for oil from more hostile lands.)

The Democrats' leaders might calculate that it is worth dressing up an energy bill with patriotic talk and weighing it down with subsidies in order to buy political support for more contentious measures. If so, they are wasting their bargaining chips. The boldest element of the current bill, the toughening of fuel-economy standards, enjoys strong support from the public, the president and leaders of both parties. Its only determined opponents are American carmakers, and even they are haggling not over the principle of more efficient vehicles, but over the scope and ambition of the new standards.

Dick Cheney is rather proud of you

What about a bill limiting emissions of greenhouse gases? The Democrats do not even plan to broach the subject until later in the year, after their first energy bill has got through. That might be tantamount to giving up. It will be hard to build momentum for a second law on much the same subject. The most exercised lobbyists and legislators will have run out of energy, so to speak. And to some cynical observers, that would seem to suit the party's upper ranks just fine: they would be happy to keep global warming in reserve as an emotive issue with which to rally supporters at the next election. The fact that so many allegedly green groups are keeping mum about this merely shows that the verdant left thinks getting Democrats elected is more important than the environment.

That is a pity. It makes little sense to start work on the nitty-gritty of cleaning up cars or power plants without setting an overall target for emissions cuts. Furthermore, if Congress were to enact some sort of overarching incentive for reduced emissions, such as a cap-and-trade system or, better yet, a carbon tax, many of the measures it is now contemplating would need no further prompting or payouts from politicians.

Global warming is the problem, after all, and fuel economy just one part of the solution. A single shot does not constitute a revolution, especially if you then run away.

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America and Iraq

Plan, don't panic

Jul 12th 2007
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Politicians in Washington have lost faith in the war. But there are good and bad ways of getting out

Reuters

Get article background

WHEN a war such as the one in Iraq turns bad, there is not always a particular moment that defines the point of defeat. Yet historians may one day come to look back at this week as the one in which politicians in Washington came to lose faith in the war (see article).

This is not because George Bush's vaunted “surge” of American troops into the Baghdad bloodbath has failed. If anything, it has so far been a modest success. The surge began in February and the full force was deployed only last month. As John McCain told the Senate this week after a visit to Iraq, the new strategy has been an improvement on the one it replaced. By venturing out of their bases to offer direct protection to Iraq's population, American soldiers have been able to reduce the sectarian killings in the capital. An offensive in Anbar province has put al-Qaeda and its local supporters on the back foot. In Diyala province American troops have moved on the city of Baquba, previously a haven in which the government's enemies had felt safe.

It was always certain that the surge would lead to the death of more American soldiers than in previous months, when the policy was to pass the burden of fighting to the fledgling Iraqi forces. The new American commander in Iraq, General David Petraeus, must report to Congress in mid-September on how his campaign is going. If he says then that no military or political progress has been made, it will be impossible for even Mr Bush to gainsay him. So why, instead of waiting two months for the general's report, have politicians in Washington allowed the debate to take on such a frantic new character?

In part, because of America's domestic political timetable. Continuing to support this war has now become a near-suicidal strategy for any ambitious politician, as the principled Senator McCain has discovered to his cost. But the defection of more and more Republicans from Mr Bush's cause cannot be put down only to a cynical calculation of self-interest. For the blunt truth is that however well General Petraeus's men may or may not be doing, Iraq's own politicians have so far shown a spectacular unwillingness to pull their weight.

The chances that the surge would provide a vital breathing-space for the incompetent, vacillating, sectarian and (lest we forget) democratically elected government of Nuri al-Maliki were always slim. But if Mr Maliki is to persuade the Americans to go on expending their blood and treasure, he must move

much faster to meet his part of the bargain. This he is showing scant sign of doing. He has got close to enacting a workable law on how Iraq's competing communities should share the riches from oil—but has once again been stymied by sectarian selfishness. There are murmurs that his government may fall and that he may be replaced by a more decisive yet more conciliatory figure. Alas, no such Iraqi paragon is in the offing. But Mr Maliki's days as prime minister are numbered, unless he can persuade his compatriots, especially his Sunni Arab ones, that he is a genuinely national leader.

This time at least, think it through

It remains possible that the prospect of an early American departure will at the last minute concentrate minds in Baghdad and bring about some kind of Sunni-Shia accommodation. Mr Bush is right to insist on waiting for General Petraeus's report in September, as he promised. But policy cannot be built around wishful thinking, and sooner or later—in the absence of a political breakthrough in Baghdad—the Bush administration will have to address the question of how to mitigate the worst effects of its probable failure.

This ought not to mean a rush for the exit. Everyone wants the Americans and their allies out as soon as possible, not least the Americans themselves. America's politicians are under pressure to bring the boys home from a failing war. But even if America decides to withdraw the bulk of its fighting forces, a great deal still depends on the manner of their going.

Getting out fast might save American lives, but risks costing a great many extra Iraqi ones if it creates panic and triggers worse sectarian bloodletting. This means that any withdrawal will have to be carefully phased, and planned in a way that enables American forces to intervene quickly in the event of an all-out slaughter taking place behind them. The Americans also need to construct a regional plan, with foes as well as allies, that will prevent the chaos of Iraq from spilling into Jordan or Saudi Arabia, or pulling in Turkey or Iran.

This will be hard; and the plan should be real, not cosmetic. But Mr Bush's barging into Iraq without adequate forethought has resulted in a debacle. The worst thing America could do now is to barge back out in the same reckless fashion.

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In praise of unequal sports

Off the ball

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European politicians should not meddle with the beautiful game

AP

Get article background

IT IS a curious irony that Europe, which often takes a dim view of market forces, lets them rip in sport, while America, usually the world's most enthusiastic exponent of commerce and its consequences for society, has all sorts of arrangements in place to mitigate its effects on the nation's favourite pastimes. But these days, the American model is gaining adherents in Europe. Sports ministers in many countries are arguing that football needs to be exempted from competition law in order to allow governing bodies to equalise the resources of clubs without risking prosecution. The European Commission's strategy paper on sport, published on July 11th, ignored those calls; but the pressure will not go away.

Professional sport differs from other businesses in one important respect. Rival teams need each other to produce a sellable product: a match. In most businesses co-operation between rivals would attract the ire of antitrust authorities. But in sport, an element of collusion is unavoidable (see article).

The balance between collusion and individualism is a hard one to strike, but has been managed reasonably well by Europe's trustbusters. The collective selling of television rights, now the main source of income for football's elite, has usually been sanctioned by the European Commission's antitrust arm. Joint marketing is defensible, because sports contests are by their nature a collaboration.

Egalitarians quibble that the bulk of the money ends up with rich well-supported clubs. The English Premier League, for instance, collectively sells its television rights and splits the proceeds between clubs. But a club's share partly depends on how many of its games are broadcast and how high it finishes in the league, so Chelsea and Manchester United get a bigger slice. The worry is that the continued dominance of national championships by a few clubs will drive away supporters.

In the United States the baseball, basketball, hockey and American football leagues try to mitigate the effects of competition and inequality through revenue- and talent-sharing agreements, such as “the draft” (baseball even has a specific exemption from antitrust law). But it is not clear that this is either necessary or desirable. Measures to increase equality within a league take the edge off competition—and therefore, presumably, off the terror that drives sportsmen to excellence.

There is more to sport than watching too well-matched teams vie for supremacy. Professional basketball in America has lost some of its shine since one of Michael Jordan's many retirements ended the Chicago Bulls' dominance of the sport. The lesson from this and from golf's popularity since the emergence of

Tiger Woods is that sporting prowess matters more to fans than strict competitive balance.

The lesson from Preston North End

European football has never been a balanced affair. The very first professional league championship in 1889 was a cakewalk for Preston North End, which went through a 22-game season without losing a match (it won in 1890 too, though never since). Championships in Portugal, Greece, the Netherlands and Scotland are nearly always won by just two or three clubs. Leagues in bigger countries are scarcely less open. Manchester United has won nine out of 15 league titles since the English Premier League was set up in 1992. None of this has impeded the global popularity of football, which has done far better as an export industry than America's more equal sports.

Politicians like the notion of equality. Sportsmen should beware it. Politics is about majorities, averages and keeping lots of people happy. Sport is about individuals, excellence and winning and losing. The two don't go well together; so it is, by and large, better for sport if politicians resist the temptation to interfere with it.

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On the Potsdam summit, America's judges, suicide, currency exchange, the number seven

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Disappointment at Potsdam

SIR – Your leader on the Doha round did the negotiations a disservice by joining Susan Schwab, America's trade representative, in her disingenuous attack on India (and Brazil, to a lesser degree) as the cause of the failure of the summit in Potsdam between the United States, the European Union, Brazil and India ("Potsdam's price", June 30th). The breakdown at Potsdam was America's fault, not India's. Ms Schwab offered to lower the ceiling on America's distorting agricultural subsidies to $17 billion. As America currently spends only about $11 billion, a ceiling of $17 billion would actually allow it to raise its subsidy level in the future.

In Ms Schwab's world, however, what is sauce for the goose is not sauce for the gander. Regarding manufacturing, she insisted that India (and Brazil) not merely lower their subsidy ceilings, but that they do so to such an extent as to bring the actual tariffs down below current levels. Aside from the double standard of the American position, India has already undertaken significant unilateral liberalisation—it cut its top industrial tariff to 10% in 2007 from 38.5% in 2001—for which it has received little credit.

The significant additional access demanded by Ms Schwab would require India to cut its ceiling by nearly 80%. But then, under the July 2004 Doha framework, such a large cut would have to be matched by near-zero tariffs in the developed countries. Ms Schwab was unwilling to make that concession.

India has had a history of being protectionist, and we have criticised it for being so. But with the exception of agriculture (where other countries are hardly a shining example either) India today is far more open than it used to be. Its merchandise and services imports are expanding at breakneck speed. During the Doha round it is doing what America and Europe have done for virtually the entire post-war period: engage in tough bargaining to obtain maximum concessions for its offers.

Jagdish Bhagwati
University professor
Arvind Panagariya
Professor of Indian political economy
Columbia University
New York

Judging the judges

SIR – The bizarre behaviour of a few state judges does not justify changing the system by which we choose such judges in America from an election-based procedure to a "merit" based selection process, as in England ("Judges behaving badly", June 30th). Sandra Day O'Connor, a former Supreme Court justice, may well think that judicial elections are akin to "political prize-fights". But how else are we to hold those who engage in political policymaking to account? Since sovereignty resides in the American people, judges, especially those who presume to exercise political power, should be made answerable to the citizens whom they wish to rule.

The debate over accountability can be extended to non-elected federal judges. Notwithstanding the fact that the partisanship displayed in Senate hearings on the nominations of Clarence Thomas and Robert Bork to the Supreme Court were nastier than any election campaign (the latter candidate being rejected), some politicians suggest introducing "litmus tests" on issues such as abortion before advising and consenting to judicial appointments.

Abraham Lincoln, in his first inaugural address, remarked that “if the policy of the government upon vital questions...is to be irrevocably fixed by decisions of the Supreme Court...the people will have ceased to be their own rulers, having to that extent practically resigned their government into the hands of that eminent tribunal.”

Ronald Buttarazzi
Fairport, New York

Safety first

SIR – It is true that many suicides could be prevented by government action (“Elusive, but not always unstoppable”, June 23rd). However, the single intervention that would save the greatest number of lives around the world is already known—the withdrawal of the most toxic pesticides from agricultural practice in rural Asia.

The World Health Organisation considers pesticide poisoning to be the major cause of suicide worldwide, killing around 300,000 people every year. Sri Lanka withdrew all highly toxic pesticides from agricultural use in the 1990s and has seen suicides drop by half. However, the number of acts of self-harm has not fallen in Sri Lanka. People continue to ingest pesticides at moments of crisis, but now the poisons they take are safer and fewer die. One option that might reduce the danger is to provide locked boxes to households so that pesticides are difficult to access at times of distress, but this may be impractical since it will require sustained monitoring by the community to keep all boxes constantly locked.

A more effective proposition is to restrict the use of highly toxic pesticides. This will save hundreds of thousands of lives a year. Although an enormous amount of political will is required, the experience of Sri Lanka shows that it can be done without affecting agricultural output.

Michael Eddleston
David Gunnell
Scottish Poisons Information Bureau
Royal Infirmary of Edinburgh
Edinburgh

Currency exchange

SIR – I would like to comment on your discussion relating to the behavioural equilibrium exchange rate, or BEER, approach to calculating equilibrium exchange rates (Economics focus, June 23rd). As you suggest, most practitioners use this technique simply to analyse which variables drive the systematic movements in real exchange rates. As the original proponent (along with Peter Clarke) of the BEER approach, I would like to stress that it can be used to define long-run economic equilibrium.

Another big advantage of the BEER method is that it can be used to separate the subjective and behavioural aspects of exchange-rate determination. Uncertainty or imprecision of equilibrium issues is, as you rightly note, an important aspect of calculating an equilibrium exchange rate and this is something that the BEER technique can incorporate. My most recent BEER estimates suggest that the Chinese yuan is undervalued by around 30%, which is dramatically different to the 1% median undervaluation you report.

Ronald MacDonald
Adam Smith professor of political economy
University of Glasgow
Glasgow

Unlucky for some

SIR – If only it were true that “rolling seven in craps always wins” (“The number of the feast”, June 30th). A roll of seven wins for gamblers on the “pass line” only until the point is set; from then on it is, in the words of my dear departed grandfather, “the devil”. Those misanthropes who bet “don't pass” have essentially the opposite pay-off. That is why the house always has an advantage.

In a sense, the craps seven is a suitable metaphor for the Las Vegas weddings on which you reported: initially a cause for great joy, but soon thereafter a source of dread and remorse.

Tim Kleiman
New York

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Internet jihad

A world wide web of terror

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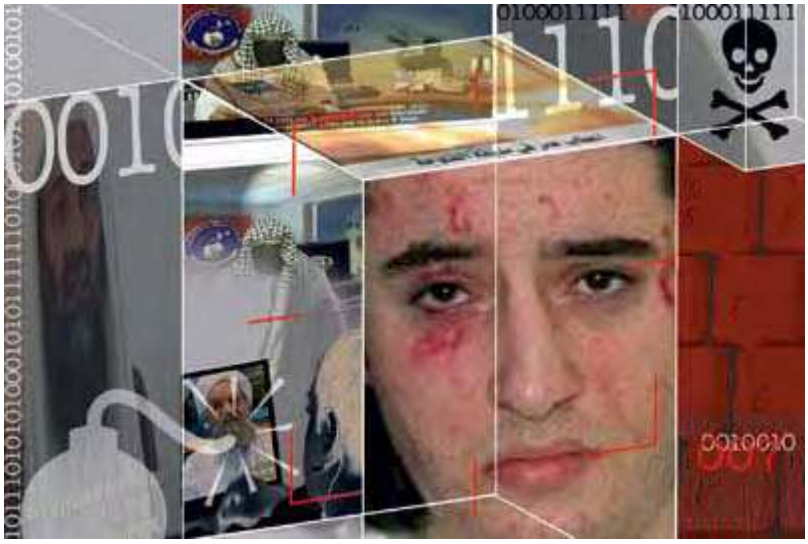
Al-Qaeda's most famous web propagandist is jailed, but the internet remains its best friend



Get article background

BY HIS own admission, he never fired a single bullet or "stood for a second in a trench" in the great *jihad* against America. Yet the man who called himself "Irhabi007"—a play on the Arabic word for terrorist and the code-name for James Bond—was far more important than any foot soldier or suicide-bomber in Iraq. He led the charge of *jihad* on the internet.

In doing so, Irhabi007 was a central figure in enabling al-Qaeda to reconstitute itself after the fall of the Taliban and its eviction from Afghanistan. Al-Qaeda ("the base") and its followers moved to cyberspace, the ultimate ungoverned territory, where jihadists have set up virtual schools for ideological and military training and active propaganda arms.

Irhabi007 pioneered many of the techniques required to make all this happen. He was a tireless "webmaster" for several extremist websites, especially those issuing the statements of the late Abu Musab al-Zarqawi, the leader of al-Qaeda in Iraq. Intelligence agencies watched powerlessly as Irhabi007 hacked into computers, for instance appropriating that of the Arkansas Highway and Transportation Department to distribute large video files, and taught his fellow cyber-jihadists how to protect their anonymity online.

Despite his celebrity, this was not good enough for Irhabi007. "Dude," he complained to a fellow cyber-jihadist (who called himself "Abuthaabit") during one encrypted web chat, "my heart is in Iraq."

> **Abuthaabit:** How are you going to have enough to go there?
> **Irhabi007:** I suppose someone gotta be here!
> **Abuthaabit:** This media work, I am telling you, is very important. Very, very, very, very.
> **Irhabi007:** I know, I know.
> **Abuthaabit:** Because a lot of the funds brothers are getting is because they are seeing stuff like this coming out. Imagine how many people have gone [to Iraq] after seeing the situation because of the videos. Imagine how many of them could have been shaheed [martyrs] as well.

Irhabi007's desire for real action may have led to his downfall. He was not only involved in a dispersed

network of *jihadi* propaganda, but also, it seems, in a decentralised web of terrorist plots. In October 2005 police in Bosnia arrested a cyber-jihadist who called himself “Maximus”, a Swedish teenager of Bosnian extraction called Mirsad Bektasevic. He and three others were later sentenced to jail terms of up to 15 years for plotting attacks that were to take place either in Bosnia or in other European countries.

Among the material recovered from Mr Bektasevic's flat, police found 19kg of explosives, weapons, a video with instructions for making a suicide vest and a video recording of masked men proclaiming their membership of “al-Qaeda in northern Europe”. On his computer they found evidence of contacts with other jihadists across Europe. Among them was Irhabi007.

Two days later, British police raided a flat in a terraced house in west London next to one of the rougher pubs in Shepherd's Bush. After an altercation, they arrested Younis Tsouli (pictured above). The elusive Irhabi007 turned out to be the 22-year-old son of a Moroccan tourism board official and a student of information technology. Two other men, also students, were arrested at the same time, although Mr Tsouli had never met them except on the internet.

The trial of Mr Tsouli and his co-defendants—Waseem Mughal, a British-born graduate in biochemistry (aka Abuthaabit), and Tariq al-Daour, a law student born in the United Arab Emirates—came to an end this month when they belatedly pleaded to charges of incitement to murder and conspiracy to murder. The court also heard that Mr al-Daour ran a £1.8m credit-card fraud and used the funds to buy equipment for *jihadi* groups. Mr Tsouli and Mr Mughal used stolen credit-card numbers to set up *jihadi* websites. Mr Tsouli was sent to jail for ten years; the others received shorter sentences.

There have been several arrests in Denmark, where a 17-year-old man of Palestinian origin was convicted last February for his involvement in Mr Bektasevic's plot. Three others were found guilty, but the jury's verdict was overturned. Irhabi007 has also been reported to be linked to plots in America, where two men living in Atlanta, Georgia, have been charged with planning attacks against civilian and military targets in and around Washington, DC, including the Capitol, the World Bank, the George Washington Masonic Memorial and a fuel depot. According to the indictment, the two men—Syed Ahmed, 21, and Ehsanul Sadequee, 19—sent Irhabi007 photographs of the proposed targets, and also travelled to Canada to meet fellow plotters and discuss attacks.

Many of the details are still subject to court restrictions. But these interlinked investigations underline the words of Peter Clarke, the head of the counter-terrorism branch of London's Metropolitan Police, who said in April that his officers were contending with “networks within networks, connections within connections and links between individuals that cross local, national and international boundaries”.

In light of this month's failed attempts to set off car bombs in London and at Glasgow airport, allegedly by a group of foreign doctors and other medical staff, one exchange of messages found on Irhabi007's computer, in a folder marked “*jihad*”, makes intriguing reading. “We are 45 doctors and we are determined to undertake *jihad* for Allah's sake and to take the battle inside damaged America, Allah willing,” ran part of it.

The message purported to set out a plot to attack a naval base, apparently Mayport in Jacksonville, Florida, with the aim of achieving the “complete destruction” of the *USS John F. Kennedy*, an aircraft carrier, and 12 escort vessels, as well as blowing up “clubs for naked women” around the base. “The anticipated number of pig casualties is 200-300,” said the author, unidentified except for the boast that he had been discharged from the Jordanian army. He claimed to have the support of a pilot who would provide air cover for the operation, but he lacked one essential piece of information that he asked Irhabi007 to provide: a guide for making car bombs. The FBI said it had investigated the plot at the time and found it to be “not credible”.

Nevertheless, the capability of the internet to promote terrorism is worrying intelligence agencies. According to America's National Intelligence Estimate in April 2006, “The radicalisation process is occurring more quickly, more widely and more anonymously in the internet age, raising the likelihood of surprise attacks by unknown groups whose members and supporters may be difficult to pinpoint.”

Bomb.com

Past technological innovations, such as telephones or fax machines, have quickly been exploited by terrorists. But the information revolution is particularly useful to them. To begin with, encrypted communications, whether in the form of e-mail messages or, better still, voice-over-internet audio, make it much harder for investigators to monitor their activity. Messages can be hidden, for instance, within innocuous-looking pictures.

More important, the internet gives jihadists an ideal vehicle for propaganda, providing access to large audiences free of government censorship or media filters, while carefully preserving their anonymity. Its ability to connect disparate *jihadi* groups creates a sense of a global Islamic movement fighting to defend the global *ummah*, or community, from a common enemy. It provides a low-risk means of taking part in *jihad* for sympathisers across the world.

The ease and cheapness of processing words, pictures, sound and video has brought the era not only of the citizen-journalist but also the terrorist-journalist. Al-Qaeda now sends out regular “news bulletins” with a masked man in a studio recounting events from the many fronts of *jihad*, whether in Iraq, Afghanistan, Chechnya or Palestine. *Jihadi* ticker-tape feeds provide running updates on the number of Americans killed (about ten times more than the Pentagon's death toll).

Battlefield footage of American Humvees being blown up to shouts of “Allahu Akbar!” (God is Great) appear on the internet within minutes of the attacks taking place. The most popular scenes are often compiled into films with musical soundtracks of male choirs performing songs such as “Caravans of Martyrs”. Jihadists have even released a computer video game, “Night of Bush Capturing”, in which participants play at shooting American soldiers and President George Bush. Inevitably, experts say, jihadists have also started to create “residents” in the virtual world of Second Life.

As well as war fantasies, there is sometimes also a dose of sexual wish-fulfilment. A video recording by a Kuwaiti ideologue, Hamid al-Ali, declares that a martyr in the cause of *jihad* goes to paradise to enjoy delicious food, drink and a wife who will “astonish your mind” and much else besides; her vagina, apparently, “never complains about how much sex she had”, and she reverts back to being a virgin.

The internet is awash with communiqués from insurgent groups extolling their own success or denouncing rivals. Even the most hunted figures, such as Ayman al-Zawahiri, the second-most-senior figure in al-Qaeda, regularly put out video statements commenting on political developments within just a few days.

In short, the hand-held video camera has become as important a tool of insurgency as the AK-47 or the RPG rocket-launcher. As Mr Zawahiri himself once put it in an intercepted letter to Zarqawi, “More than half of this battle is taking place in the battlefield of the media.” Or as one *jihadi* magazine found on Irhabi007's computer explained: “Film everything; this is good advice for all mujahideen [holy warriors]. Brothers, don't disdain photography. You should be aware that every frame you take is as good as a missile fired at the Crusader enemy and his puppets.” Just before his arrest, Irhabi007 had set up a website that, he hoped, would rival YouTube, to share *jihadi* videos. He called it Youbombit.com.

Of jihad and camels

The internet's decentralised structure, with its origins in military networks designed to survive nuclear strikes, now gives *jihadi* networks tremendous resilience. *Jihadi* websites constantly come and go, sometimes taken down by service providers only to reappear elsewhere, sometimes shifted deliberately to stay ahead of investigators. As one expert put it: “It's like the old game of Space Invaders. When you clear one screen of potential attackers, another simply appears to take its place.”

The number of extremist websites is increasing exponentially, from a handful in 2000 to several thousand today. Some are overtly militant, while others give *jihad* second place to promoting a puritanical brand of piety known as “salafism”, that is modelled on the earliest followers of the Prophet Muhammad and regards later developments as degenerate. Most are in Arabic, but some have started to translate their material into English, French and other languages to reach a wider audience.

The most headline-grabbing material on the internet is the military manuals—whether as books, films or

PowerPoint slides—giving instruction on a myriad of subjects, not least weapons, assassination techniques, the manufacture of poisons and how to make explosives. But intelligence agencies say there is nothing like having hands-on experience in a place like Iraq, or at least a training camp. In the latest attempted attacks in London and Glasgow, for example, the attackers clearly botched the manufacture of their car bombs even though many of the alleged plotters were well educated.

Still, internet-based compilations such as the vast and constantly updated “Encyclopedia of Preparation”, as well as militant e-magazines such as the *Tip of the Camel's Hump* (used to mean “the pinnacle”) found on Irhabi007's computer, make it easier for self-starting groups around the world to try their hand at terrorism. The Dutch counter-terrorism office, which publishes many of its studies on extremism, concludes that the existence of virtual training camps “has the effect of lowering the threshold against the commission of attacks”.

Many *jihadi* websites put their most inflammatory information and discussions in password-protected areas. Here participants can be gradually groomed, invited to take part in more confidential discussions, drawn into one-on-one chats, indoctrinated and at last recruited to the cause.

But the very anonymity that the internet affords jihadists can also work against them; it lets police and intelligence agencies enter the jihadists' world without being identified. Many postings to web forums are filled with (rightly) paranoid postings about who is watching. A lengthy posting on a Syrian *jihadi* site in 2005, entitled “Advice to Brothers Seeking *Jihad* in Iraq”, said raw recruits offering only “enthusiasm or impetuousness or love of martyrdom” were no longer wanted. Instead, the mujahideen needed money and experienced fighters, but they should not assume that the smuggling routes through Syria were safe. It advocated communicating in secret through trusted sources in mosques rather than on the internet, noting that “this forum, like the others, is under...surveillance; any information is obviously not secret, so any individuals you meet and correspond with on the forums cannot be trusted at all.”

Contributors to *jihadi* web sites are regularly told not to divulge secrets. When news of Irhabi007's arrest emerged last year, some of the postings stressed the need for greater caution online. One of these, signed by “Badr17”, gave the warning “Trust in Allah, but tie your camel.”

Open university of jihad

One of the most prolific al-Qaeda strategists is Abu Musab al-Suri. He is now in American custody, but his 1,600-page opus, “The Global Islamic Call to Resistance”, survives. It advocates the creation in the West of self-starting, independent terrorist cells, not directly affiliated to existing groups, to stage spectacular attacks.

For many who study the *jihadi* websites, however, the bigger danger is indoctrination. The Dutch domestic intelligence service, the AIVD, regards the internet as the “turbocharger” of *jihadi* radicalisation. Stephen Ulph, a senior fellow at the Jamestown Foundation, an American research institute that monitors terrorism, says the internet provides an open university for jihadists. At least 60% of the material on *jihadi* websites deals not with current events or with war videos, but instead concerns ideological and cultural questions. Jihadists, Mr Ulph says, are fighting less a war against the West than “a civil war for the minds of Muslim youth”. In this process of radicalisation, “the mujahideen attract the uncommitted armchair sympathiser, detach him from his social and intellectual environment, undermine his self-image as an observant Muslim, introduce what they claim is ‘real Islam', re-script history in terms of a perennial conflict, centralise *jihad* as his Islamic identity, train him not only militarily but also socially and psychologically.”

A key text is the ever-expanding e-book, “Questions and Uncertainties Concerning the Mujahideen and their Operations”, which seeks to arm jihadists with responses to questions and doubts about their actions, ranging from the admissibility of killing Muslims, the use of weapons of mass destruction and the acceptability of shaving one's beard for the sake of *jihad*. “It is important we do not get distracted by focusing on organisations rather than against ideology,” argues Mr Ulph.

The point is underlined in a study by the Combating Terrorism Centre at America's military academy at West Point, which has tried to “map” the most important ideological influences by searching citations in *jihadi* online documents. Top of the list is Ibn Taymiyya, a scholar who lived at the time of the medieval Mongol invasions. He strove to return Islam to the pure faith of Muhammad's followers, advocated *jihad* to repel foreign invaders and taught that Mongol leaders who converted to Islam were not really Muslims because they did not implement *sharia*. These ideas strike a chord with today's jihadists, who see

Americans as the new Mongols.

Osama bin Laden does not make the top ten most-cited figures, even among modern authors. Abu Muhammad al-Maqdisi, the theorist jailed in Jordan (and who directly inspired Zarqawi), is regarded as a higher authority. And Mr Zawahiri, the ubiquitous internet propagandist who is often described as the real brains behind al-Qaeda, does not even figure in the jihadists' intellectual universe.

Western intelligence agencies trawl the internet to look for evidence of terrorist plots, but lack the resources or desire to challenge the wider ideology. In a global network, outside the control of any single government, attempts to close down extremist sites are little more than short-lived harassment. What is needed is a systematic campaign of counter-propaganda, not least in support of friendly Muslim governments and moderate Muslims, to try to reclaim the ground ceded to the jihadists.

“Intelligence agencies are dealing with the problem once people have manifested themselves as existing terrorists,” says Professor Bruce Hoffman, an expert on terrorism at Georgetown University. “We have to find a way to stanch the flow. The internet creates a constant reservoir of radicalised people which terrorist groups and networks can draw upon.”

So Irhabi007 may be off the internet, but others like him remain. Among the most prolific is a figure who roams the web by the name of, yes, Irhabi11.

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Congress and Iraq

Pushed for a pull-out

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Reuters

As Democrats in Congress crank up the pressure to withdraw from Iraq, some Republicans are deserting their president

Get article background

GEORGE BUSH wants Americans to take the long view. When his father was fresh out of school he joined the navy, became a bomber pilot and fought the Japanese, the president told a crowd in Cleveland on July 10th. In those days, he said, the Japanese were America's sworn enemy. But because millions of Americans fought tenaciously to bring freedom to Asia, the Japanese are now friends.

In January Mr Bush said he would send roughly 20,000 extra troops to Iraq. America's top general there, David Petraeus, argued that such a “surge”, concentrated on Baghdad and Anbar, the most violent province, was the only way to make Iraq safe enough to start functioning as a society. The last of those extra troops arrived on June 15th. “They just showed up,” said Mr Bush, “and they're now beginning operations in full. And in Washington you got people saying, stop.”

The Democrats lost patience with the war long ago. And with an election next year, public opinion souring and attack ads already hammering pro-war Republicans in swing states, some of Mr Bush's allies are turning on him too. Three Republican senators, Chuck Hagel, Gordon Smith and Olympia Snowe favour getting out by next April. Several others are wavering. Richard Lugar, a Republican senator from Indiana, says the surge is unlikely to work “within the short period framed by our own domestic political debate”.

Sensing weakness, Democrats are surging to the microphones. Campaigning in Iowa, Hillary Clinton said: “It is time to begin ending this war. Not next year, not next month, but today.” John Edwards, another would-be president, said that Congress “should no longer facilitate the president's stubborn allegiance to his failed strategy”. Democrats in the Senate, meanwhile, have been mulling five ways to tie the hands of the commander-in-chief.

All five are amendments to next year's must-pass defence appropriations bill. One was sponsored by Jim Webb, a Democrat from Virginia, and Mr Hagel, a Republican from Nebraska. It called for American troops to be given a longer respite between tours of duty because, Mr Webb said, soldiers are burning out. If passed, it would have forced a reduction in troop levels in Iraq. When the idea was previously proposed, by Jack Murtha, a House Democrat, its author admitted that it was a slow-bleed strategy to end the war. Mr Webb withdrew his amendment on July 11th. Mr Hagel has proposed a much tougher

one.

Another amendment, sponsored by Carl Levin and Jack Reed, two Democrats, calls for American troops to start pulling out of Iraq within 120 days, with a goal of complete withdrawal by next spring. Mr Bush says he will veto this if it passes. As yet, too few Republicans have switched sides to override a veto, but Harry Reid, the Democrats' leader in the Senate, is fishing for more. He is slowly getting closer.

A third amendment, sponsored by Ken Salazar, a Democrat, and Lamar Alexander, a Republican, would oblige Mr Bush to implement the recommendations of the Iraq Study Group, a bipartisan commission that last year urged more energetic diplomacy with Iraq's neighbours and a rapid shift of American troops from combat missions to training the Iraqi army. This amendment could well pass.

The two most dramatic amendments have little chance of enactment. Mrs Clinton proposes that Congress revoke the authority it gave Mr Bush in 2002 to wage war. Russ Feingold, a Democrat from Wisconsin, urges that all funds for the war be cut off after March 31st, apart from those needed to hunt terrorists, protect American soldiers and train Iraqis.

The counter-attack

On the Senate floor, Mr Bush's remaining supporters fought back furiously. John McCain, freshly returned from the front line, said there were signs the surge is working. In Anbar province, which a leaked military memo last year concluded was lost to al-Qaeda, the locals have decided that they would rather join the new Iraq than submit to Osama bin Laden's medieval vision for their country.

Tribal sheikhs in Anbar have switched sides and started helping the Americans flush out foreign *jihadis*. Ramadi, once the most dangerous city in Iraq, is now one of the safest. As security improves, the space is opening for political progress, said Mr McCain. Yet Democrats are urging that American forces pull back to their bases and restrict themselves to training the Iraqi army and hunting terrorists. That, said Mr McCain, was the strategy of Donald Rumsfeld, the defence secretary who was sacked last year. It failed. Mr McCain said he was “frankly surprised” that his colleagues in the Senate would want to try it again.

The hawks are relying on hard strategic arguments. The surge might work. Every other plan would allow Iraq to fall apart, with genocidal consequences. An American defeat in Iraq would attract legions of new recruits to al-Qaeda and embolden the terrorists to ignite the Middle East and renew their attacks on America itself.

The doves appeal to softer emotions. Debbie Stabenow, a Democratic senator from Michigan, invoked the plight of the 1,644 members of the Michigan national guard stuck in Iraq with sand blowing in their faces, far from “their 1,644 families and missing birthdays, Father's Day, Mother's Day...high school graduations [and] baby's first steps.”

Such appeals are working. A Gallup poll this week showed that seven in ten Americans want nearly all troops out of Iraq by April. The same poll showed Mr Bush's approval rating at a new low of 29%. The only bright spot for him was that 55% thought Congress should wait until mid-September, when General Petraeus will deliver a report on the surge's progress, before deciding what to do next. An interim report, due out by the end of this week, was reported to show mixed results: parts of Iraq are safer but its government is making only very slow progress towards meeting a long list of political benchmarks Congress earlier set for it, such as passing a law sharing Iraq's oil revenues fairly. The battle has much longer to rage.

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Congress debates climate change

Full of sound and fury

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The legislature grapples with a bewildering array of ideas about energy

IF THE Democrats fail to overhaul America's energy policy, it will not be for lack of ideas, both good and bad. Last month the Senate approved a bill that would force carmakers to produce less fuel-hungry vehicles and fuel-makers to produce more ethanol, among other things. The House of Representatives, for its part, has passed legislation that would raise taxes on oil companies. Different committees have given the nod to various other measures, including a requirement to increase power generation from renewable sources such as wind and sunshine. The Democratic majority in both chambers has promised to stitch some of these proposals together into a single energy bill this summer. But there is little consensus on what to include and what to drop (see chart).

Ways and means

Congress's plans for greenery

	Fuel economy	Energy efficiency	Ethanol	Renewable electricity	Windfall tax on oil companies	"NOPEC"
In likely House bill	?	✔	✘	✘	✔	✔
In Senate bill	✔	✔	✔	✘	✘	✔
Popular with	Drivers	Everyone but...	Farmers	Greens	Unthinking drivers	Everyone but...
Unpopular with	Detroit	...builders and utilities	Economists	Southerners	Wiser drivers	...OPEC, George Bush
Chances	Good	Near certain	Good	Poor	Veto likely	Veto likely

Source: *The Economist*

The biggest battle will be over fuel-economy standards, which Congress has not raised significantly since 1975. The Senate's bill would increase the average standard for new vehicles to 35 miles per gallon by 2020 from the current 25mpg—a target that would require improvements for light trucks and sport-utility vehicles as well as cars. But in the House, fuel economy is the domain of the Energy and Commerce committee, which is chaired by John Dingell, a congressman from Michigan who is a firm friend of the car industry. America's troubled carmakers insist that 35 mpg is unattainable, although the National Academies of Science says it is possible. Vehicles in Europe and Japan already exceed that level.

At Mr Dingell's behest, the committee has put off a debate about fuel economy, and instead approved a bill that would require appliances, but not cars, to be more energy-efficient. The House leadership, however, might still allow an amendment on fuel economy to be inserted into the bill when the full chamber debates it. Nancy Pelosi, the speaker, had originally intended to put an energy package to a vote before July 4th, but has delayed, pundits say, to rally support for such an amendment. Even carmakers seem to accept that change is inevitable, as they have grudgingly endorsed bills that would require smaller but still substantial increases in fuel economy.

The Senate package would also require America's fuel distributors to sell seven times more ethanol than they currently do by 2022, to help reduce both America's reliance on oil imports from hostile regimes and its emissions of greenhouse gases, which cause global warming. The idea goes down well with farmers, who grow the corn from which most ethanol is currently made. So it also goes down well with politicians hoping to curry favour in the farm states of the Midwest. George Bush supports it too, even though corn-based ethanol is heavily subsidised and has relatively little impact on either oil imports or overall greenhouse-gas emissions. Given such overwhelming bipartisan support, the House is also likely to give a bigger ethanol mandate the nod, although perhaps in a forthcoming agriculture bill rather than as part of an energy package.

Both the Senate and the House also seem to agree on a measure known as "NOPEC", which aims to

punish the Organisation of the Petroleum Exporting Countries for driving up oil prices. It would allow the government to sue members of OPEC in American courts for anti-competitive behaviour. Such populism would doubtless go down well with drivers chafing at the high price of petrol. But it is hard to see how it could be implemented without prompting diplomatic crises, trade wars and, probably, higher oil prices. Mr Bush, at any rate, has vowed to veto it.

The president is also likely to veto a bill passed by the House earlier this year that denies oil companies a lucrative tax break, as a sort of windfall tax on their current record profits. Republicans argue that Congress should be making life easier for oil companies, not harder, in order to encourage them to produce more oil. They have proposed opening new areas to oil drilling, but Democrats will not countenance that.

Renewable electricity is another bone of contention. A proposal to oblige utilities to generate 15% of their power from renewable sources by 2020 has foundered amid a row over whether nuclear power should be included. Proponents of the measure have pledged to revive it, but lawmakers from the South, where there are plenty of nuclear plants but not that many wind farms, are strongly opposed.

The future of coal is also a subject of great debate. Congressmen from coal-rich states have secured generous funding for research into carbon sequestration, a nascent technology that would capture carbon-dioxide emissions from coal-fired power plants and store them underground, thus improving the environmental credentials of what is currently the dirtiest of fuels. But the coal lobby has so far failed to win any favours for a form of diesel made from coal, which would increase America's emissions of greenhouse gases.

One measure that definitely will not be included in any bill is a cap on emissions. On July 11th Jeff Bingaman, a senator from New Mexico, unveiled a bill on the subject, to add to the many in circulation. But the Democratic leadership has decided to delay consideration of them all until the autumn. The odds on any of them becoming law look slim, given how hard Congress has found it to agree on pettier matters. And as for a carbon tax—forget it.

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Presidential candidates

Hitting the buffers

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John McCain's campaign nears its end

JOHN McCAIN returned from Iraq on July 6th to face an impending bloodbath of his own. His two top campaign aides, Terry Nelson and John Weaver, resigned abruptly; his chief of staff, Mark Salter, removed himself to the sidelines. Other senior aides also headed for the door. Six months ago Mr McCain was the Republican front-runner—the George W. Bush of 2008. Now the big question hanging around his neck seems not whether Mr McCain will withdraw, but when.

Presidential campaigns have survived similar shake-ups in the past. Ronald Reagan and John Kerry both sacked their campaign managers before going on to win their party nominations. And Mr McCain's senior staff bears some responsibility for a badly managed campaign. Mr McCain has been spending money like a first-division candidate while earning it like a third-division one. He has less money on hand than even the maverick Texan libertarian Ron Paul, and has been forced to lay off dozens of his staff of 120.

But this is more than a shake-up. Mr Weaver is not just a hired gun. He is part of Mr McCain's political family—the man who encouraged him to run for the presidency in the late-1990s, who invented the idea of the “Straight Talk Express”, who marched by his side for years.

And Mr McCain's problems go a lot deeper than mismanagement. The self-styled straight talker is badly out of tune with the American people. His unswerving support for the Iraq war has alienated the swing voters who swooned over him in 2000. So has his willingness to cosy up to the religious right. His support for immigration reform has alienated the hard-line conservatives who vote in the primaries and give money to Republican candidates. Rudy Giuliani is well ahead of him in national polls, and Mitt Romney is trouncing him in Iowa and New Hampshire.

Nor has Mr McCain helped himself by the way that he has handled the deteriorating situation. How can he claim to be a champion of fiscal responsibility when he allows his campaign managers to spend like drunken sailors? And can he revel in being a straight shooter when he has just shot his two closest advisers? The fact that Mr McCain reportedly blew up at Mr Nelson reinforces long-standing worries that he is too hot-tempered to be trusted with the top job.

The two most likely beneficiaries of Mr McCain's troubles will be Rudy Giuliani, the front-runner, and Fred Thompson, an old friend of Mr McCain's who is expected to declare his candidacy any day now. Mr Thompson has assiduously courted social conservatives, who are discontented with the existing field. But on July 7th the *Los Angeles Times* reported that back in 1991 Mr Thompson accepted a lobbying job that required him to help persuade the first Bush White House to allow family-planning clinics that receive federal funds to offer advice on abortions. Team Thompson denies the story. However, the lobbying group's minutes support it, potentially branding the candidate a liar as well as unsound on abortion. Not a great start for a man who is not yet formally in the race.

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Circuses

Send home the clowns?

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Big Tops feel the pinch

AT 23, Steven Copeland is one of the senior clowns performing with Ringling Bros. and Barnum & Bailey, America's leading traditional circus. His alter ego is Super Steve, a hero clown in a hat and cape of newspaper-print fabric. Clowning has its occupational hazards. One of Mr Copeland's colleagues recently broke his stilts in a fall. But Mr Copeland is happy he joined the circus. He has, he said, made many friends and had interesting experiences.

A hundred years ago, he would have been a bigger star. At the beginning of the 20th century the circus was a representative icon of modernity, as Janet Davis of the University of Texas puts it. Circuses had international casts and used impressive new technology such as half-tone photographs. They showed rural Americans a wider world. Circus day could stop all other commerce, as schoolchildren and businessmen took the day off to crowd under the Big Top. In one year nearly 100 outfits criss-crossed the country.

Today Ringling stages the largest touring, traditional circuses left in America. (Traditional mostly stationary circuses include the Big Apple in New York; Cirque du Soleil tours, but does not feature tigers or strong men catching cannonballs.) Circuses hardly feature in the cultural landscape. Perhaps there are so many new forms of entertainment that spectacles have become commonplace. It sometimes seems that half the people on television belong in a side-show.

But the circus is changing. In 2006 Feld Entertainment, which owns Ringling, overhauled one of its two main circus productions. They abandoned the three-ring format in favour of one large ring and added a plot. In The Circus of Dreams, a family is plucked from the audience and invited to join the circus. As luck would have it, the “family” includes an actor, a dancer, an aerialist and an acrobat. It is hard to say whether such changes have improved the bottom line. Feld Entertainment is privately held and its CEO, Kenneth Feld, declines to talk numbers. But attendance is healthy and audiences are appreciative. They seem to enjoy most the traditional thrills: human tricks and animal acts. Last month 100 people in Tupelo, Mississippi, gathered to watch a Ringling elephant get a bath at the fire department. This, said one father, is a first.

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New York state politics

Now, now, boys

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Feuding politicians are not helping political gridlock

RELATIONS between New York's governors and its state legislature have traditionally not been good. Hugh Carey, the state's Democratic governor in the 1970s, compared the body to a zoo. Governor Mario Cuomo, another Democrat, had constant problems with Albany, the state capital, where the legislators sit. There was little love lost between George Pataki, Republican governor from 1995 to the end of 2006, and Sheldon Silver, the Democratic speaker of the Assembly. So it's no surprise that Eliot Spitzer, the steam-roller of a new Democratic governor, and Joe Bruno, the Republican majority leader in the state Senate, are not getting along. But even by Albany's standards their recent feuding has caused new highs, or rather new lows, of dysfunction.

AP

“Senile” Bruno (left) takes on “dictator” Spitzer

Last week news emerged that Mr Bruno may have misused state aircraft for political fund-raising. Mr Bruno claims he did some state business on those trips, which thanks to a convenient loophole means the use of state helicopters and aeroplanes could be permitted. He, for his part, is accusing Mr Spitzer of ordering New York state police to keep detailed logs of his travels. The governor denies that charge. Still, Mr Spitzer has been relentless in attacking Mr Bruno, who has been equally vitriolic in return. The feud has played out publicly, with the two politicians venomously attacking each other with words such as “senile” and “dictator”.

The state attorney-general, who reports to Mr Spitzer, is looking into Mr Bruno's trips. The latter is already being investigated by federal authorities over his personal business dealings in property and sales of thoroughbred horses. But Mr Spitzer, who was elected on a mandate to shake up Albany, is in danger of becoming a persecutor rather than a leader, according to Doug Muzzio, a professor of politics at Baruch College. Mr Muzzio and others including Ed Koch, a former mayor of New York, think Mr Bruno's arguments are beginning to resonate with New Yorkers. Gerald Benjamin, of the State University of New York at New Paltz, says the public is getting fed up with the bickering.

The sparring politicians have now started to moderate their behaviour, in part because their dust-up has distracted, if not indeed halted, state business. The legislature, which went into recess last month, had tentatively scheduled a meeting to deal with outstanding issues such as campaign finance, the amending of Wick's Law, an antiquated and costly construction mandate, and a proposal from Michael Bloomberg, New York City's mayor, for a congestion charge in Manhattan. New York is the rumoured front-runner to receive some $500m in federal funding for mass transit improvements, but only if the state legislature approves the controversial congestion-pricing bill by July 16th.

As *The Economist* went to press, it was extremely doubtful whether Mr Silver, no fan of congestion pricing, would recall the Assembly to do it. Mr Spitzer and Mr Bruno actually agree on charging drivers to enter busy parts of Manhattan. But if Mr Silver does not bring the bill to the floor, says Mr Bloomberg, congestion pricing is unlikely to happen. Some lawmakers think the air in Albany is now too poisonous to get anything done.

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Mobile phones

Towers of trouble

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Great reception, sorry about the view

DOUG ROGERS, a retired bakery owner in Vernon, Vermont, built his dream house several years ago, on a hilltop with fabulous views. But he fears he could end up staring at a 100-foot (30m) mobile-phone tower. Verizon, an American wireless giant, is hoping to install one on his neighbour's property. Mr Rogers says it would soar above his maples and oaks. He has complained vigorously to town authorities, and Verizon is now investigating a different site nearby. The state of Vermont is scarred enough, says Mr Rogers, who can already clearly see another mobile tower on a ridge a few miles away.

Similar disputes are breaking out across America. Everybody wants good mobile coverage (Mr Rogers admits to being quite happy with the service he gets at home from US Cellular). But no one wants an eyesore. That is true even if, as Verizon plans near Mr Rogers, it is disguised as a (very tall) tree, with rubber bark.

The rows call to mind other battles over wind turbines. But opponents of mobile towers sometimes point to an extra worry: radiation. One farm owner in Pennsylvania recently (and so far unsuccessfully) opposed a tower because he feared it might affect his horse-breeding operations. The industry insists the towers are safe.

Mobile-phone companies say that demand is exploding and they must build to meet it. But putting up towers is a last resort, says Anne Patrick, the New England marketing director for T-Mobile. She reckons that only about 5% of her new placements this year would involve building a new tower. Towers are expensive as well as ugly; Verizon says that new ones in Vermont average $900,000 each; more often, antennas are added to existing utility poles, church steeples or other structures. One virtue of Vermont is that it has more trees than, say, Texas to hide them.

Bringing wireless to the countryside is uneconomical in any case, so the priority tends to be urban areas and interstate highways. Indeed, hilly, rural Vermont has notoriously spotty coverage. The governor, James Douglas, has just signed a bill that is supposed to bring broadband and mobile access to virtually all Vermonters by 2010 (good luck!). It creates a Vermont Telecommunications Authority that is supposed to make it easier to get permission for wireless structures and provide public funding to push broadband and wireless expansion, among other measures.

Other parts of New England are also lobbying for more coverage, for safety reasons. One of Maine's senators, Susan Collins, has complained that she had to drive 20 minutes to a hill before being able to take a call from Michael Chertoff, the homeland security secretary, about last year's terrorist plots against airlines operating from Britain. And New York's governor has just pledged to end the dead zone along nearly 50 miles (80 km) of interstate in Adirondack Park between New York and Montreal. In January a man died of hypothermia there after his car broke down and he could not summon help.

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San Francisco's half-recovery

City in a bottle

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The strange half-recovery of California's prettiest city

TO JUDGE by the interminable queue outside Boogaloos restaurant in the Mission District, San Francisco is thriving again. And there are other signs of recovery. Offices vacated during the dotcom crash are occupied by new web-based outfits. In an area that hosted anti-yuppie marches in the late 1990s, Latino businesses are again being turfed out to make way for juice bars and bike shops. The influx of wealth is less alarming these days, if only because it seems so inexorable. “It's taken as a fact of life now,” says Nickolas Pagoulatos, a local activist.

Yet this boom is unlike the one that began ten years ago. For one thing, it has produced many fewer jobs. Although slowly rising, the number of workers in San Francisco is still 12% lower than during the dotcom era. Since 2000, indeed, the city has shed more jobs than Detroit. And the losses have not just been in the frothy high-tech world. The city's finance and insurance industry has moved or made redundant 15% of its workers, and now employs fewer people than during the recession of the early 1990s. Outside a few niches, manufacturing seems to be in terminal decline.

The face of San Francisco is changing, too. Like other big cities, it is being abandoned by blacks; more unusually, Hispanics are also leaving. Long a childless place, it is becoming ever older. During the boom years of the late 1990s, the city sucked in young people. Since the bust, some of them have aged and others have left, not to be replaced. The Association of Bay Area Governments reckons the population of twenty-somethings in San Francisco fell by 38% between 2000 and 2005.

Boosters, of which there are many, argue that the city is just as vital as it ever was. It remains, they say, the place where everybody wants to be: witness the concentration of highly-qualified residents and the decision to put a new stem-cell research institute there. San Francisco is, indeed, one of America's most alluring and urbane spots. Next to it, every other big city in California resembles a glorified suburb. Yet Kevin Starr, the state's premier historian and a San Francisco native, says that it should really be compared with a more distant place: Monte Carlo.

More than biotechnology or Web 2.0, San Francisco's economy these days is built on leisure. That industry is in fine fettle: bucking the trend, hotels and restaurants employ more people now than they did seven years ago. Domestic tourists scared off by al-Qaeda in 2001 have returned. So have international visitors, lured from Europe by the weak dollar and from Asia by the city's strong links to China. As a result, the cable cars trundling up Nob Hill these days resemble cattle trucks.

And tourists are not the only reason restaurants are full. Michael Covarrubias, a San Francisco property

developer, says many expensive flats have been bought by people in their late fifties who have grown tired of the suburbs and no longer need worry about schools. Although lured by the city's bright lights, they may not see much of them. Rich Robbins, another developer, says another trend is towards *pieds-à-terre* that are empty most of the time. While building homes in Idaho for Californian clients, he was surprised to learn that many planned to do much of their work from the country, heading into the Bay Area only for the occasional meeting, or to catch an opera.

Younger workers often have a similarly detached relationship with the city. Google shuttles 1,200 people a day, many of them from the Mission and other trendy parts of San Francisco, to its headquarters in suburban Mountain View. Such reverse commuting helps to explain why property prices in the city barely wobbled during the dotcom crash. Although it has been flat during the past year, the housing market remains the fourth-least affordable in America, says the National Association of Home Builders.

Those prices pose the greatest threat to the city's future as a crucible of new ideas. Talented people are not always rich, and San Francisco is in danger of losing those who are not to less fashionable places. Alameda County, which includes scruffy Oakland, attracted 40,000 people with bachelors degrees between 2000 and 2005, according to the census—three times as many as San Francisco. Sacramento, a notoriously dull (and cheap) county further to the east, added even more. At present, places such as Sacramento are the bedrooms of the Bay Area. But Pete Bernardoni, a local venture capitalist, says companies have begun to take note of Sacramento's increasingly skilled residents. The main obstacle to more rapid high-tech growth, he says, is that it can be hard to persuade executives to live there.

In November the people of San Francisco will vote for a mayor. They are likely to re-elect Gavin Newsom, a charming man who is best known (particularly among conservatives) for allowing gay couples to marry in City Hall. Although he has tried to make the city more appealing to business, Mr Newsom has presided over a lacklustre economy. And much of the motley crew that plans to run against him—a group that includes a nudist and a man known as Chicken John—would like to see less development, not more.

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Lexington

Dead man walking

Jul 12th 2007
From The Economist print edition

Kevin Kallaugher

Alberto Gonzales's Justice Department is falling apart

EVERYBODY loves an up-by-your-bootstraps success story. Alberto Gonzales grew up in a two-room shack in Humble, Texas, without hot water, a telephone or air-conditioning. His parents were itinerant workers who did not make it to high school. He was the only one of eight siblings to go to university. But he is now America's 80th attorney-general—and the first Hispanic to hold such an exalted position.

The only problem with this happy tale is that Mr Gonzales is proving to be disastrous in the job. Worse than the ham-fisted Janet Reno. Worse than all but a handful of his forerunners. So bad that John Ashcroft, his puritanical and polarising immediate predecessor, looks like an administrative titan by comparison.

Mr Gonzales is currently at the centre of a constitutional tug-of-war between Congress and the White House. Congress has subpoenaed two former White House aides to answer questions about the dismissal of nine US attorneys, or government prosecutors, last year. (The Democrats say they were sacked because they refused to do the bidding of George Bush's political machine. The administration denies this, but has failed to produce a plausible counter-explanation.) Expect plenty more tugging and counter-tugging in the weeks to come. A second tussle is going on over documents relating to a wiretapping programme operated by the administration without proper authorisation.

These two affairs have already done a great deal of damage to the Department of Justice, which the attorney-general heads. Mr Gonzales himself has destroyed whatever reputation he might have had with his lobotomised performances on Capitol Hill. (During one session he said that he “did not recall” events related to the controversy no fewer than 70 times.) Senior staff have jumped ship. Others describe the morale of the place as “rock bottom”. Politicians on both sides of the aisle describe the department as “dysfunctional”, “crippled” and “a shambles”.

Which is not a situation that anyone should take lightly. The Justice Department is an important part of government at any time, and especially after September 11th 2001. It is partly responsible for domestic security (it is responsible for the FBI). It is also grappling with some of the most pressing legal issues of the moment. How far should America go in detaining terrorist suspects? Or in getting them to talk? How much latitude should the government have to spy on American citizens? The feeling is widespread that America sacrificed too many freedoms in the immediate aftermath of September 11th; some re-

calibration is in order. But there is little chance that Mr Gonzales's department can produce anything useful in this or any other regard.

Mr Gonzales was arguably the worst person possible for the job. People who have worked with him describe him as neither particularly bright nor particularly forceful. The “forgetful” performance on Capitol Hill may have been tactical. But he clearly took a lackadaisical approach to his job. The prosecutor for Arizona objected to Mr Gonzales's decision to seek the death penalty for a drug dealer who was accused of murder on the ground that, among other things, no body had been found. Mr Gonzales's aide said the attorney-general had invested a lot of time in the issue—perhaps “as much as five to ten minutes”.

Once a flunkey, always a flunkey

Mr Gonzales is also much too close to Mr Bush to be able to do his job properly. Mr Bush plucked him from (lucrative) obscurity as a Houston property lawyer to make him his general counsel in 1995, when he became governor of Texas. He later made him Texas's secretary of state and then a justice on the Texas Supreme Court. In 2001 Mr Gonzales followed Mr Bush north to work as his general counsel in the White House. Mr Gonzales was once asked to list the biggest influences on his life. His answer was, “My mom, my dad and our president.”

Mr Gonzales's position as Mr Bush's in-house lawyer means that his fingerprints are all over some of the most dubious decisions of recent years. Even before September 11th he advised the administration on how to keep the proceedings of the energy task-force secret. After September 11th he took a persistently aggressive stance on security—dismissing the Geneva Conventions as “obsolete” in regard to terrorists, helping to draw up guidelines for the treatment of terrorist suspects and, generally, pandering to his boss's hardline prejudices.

During his confirmation hearings Mr Gonzales assured lawmakers that he understood the difference between his former job and the job he coveted: his client would now be the American people rather than the president. This was always going to be a hard distinction to maintain, given Mr Gonzales's role in crafting the policies he was being asked to evaluate as attorney-general. But in practice Mr Gonzales has shown few signs of even trying to draw it. He has gone out of his way to put a positive spin on the administration's anti-terrorism policies. In April 2005, for example, he assured the Senate that the FBI had never abused its new anti-terrorism powers despite having received internal reports to the contrary.

The collapse in confidence in Mr Gonzales is now complete. Democrats who once welcomed him on the theory that at least he was better than his predecessor are now pining for the good old days of Mr Ashcroft. (Mr Ashcroft once refused to sign off on the legality of a wiretapping programme when he was attorney-general; Mr Gonzales joined a White House deputation to his sick bed to try to force him.) Middle-of-the-road Republicans are embarrassed by him. And conservatives dislike him because of his liberal views on affirmative action and abortion. But Mr Gonzales is almost certainly there for the duration. The White House can ride out a subpoena or two. And besides, where else is Mr Bush going to find a chief law enforcement officer who is going to be equally pliable? Too bad for Justice.

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Colombia

A hero at home, a villain abroad

Jul 12th 2007 | BOGOTÁ
From The Economist print edition

AFP

Colombians reckon that Álvaro Uribe saved their country. It's a pity for them that so many outsiders don't see their president that way

Get article background

WHEN hundreds of thousands of Colombians poured into the streets on July 5th to protest at the killing of 11 hostages who had been held by the guerrillas of the Revolutionary Armed Forces of Colombia (FARC), President Álvaro Uribe chose to read this as support for his tough security policies. “This demonstration is notice to the international community that we cannot, in this hour of pain, give in to the criminals,” he said. But much of the “international community” no longer sees events in Colombia in the way most Colombians do.

At home Mr Uribe is seen as the saviour of a country that was in danger of being turned into a failed state by the rampaging violence of drug-traffickers, left-wing guerrillas and right-wing paramilitaries. Since he took office in 2002, violence has fallen sharply. As confidence returns, the economy is growing at 8% a year. According to Invamer-Gallup, a pollster, Mr Uribe's approval rating has remained steady at between 70% and 80% over the past year.

That is despite recent scandals in which a dozen legislators who support him, as well as a former intelligence chief, have been arrested on suspicion of having ties to the murderous paramilitaries; the latest to face investigation is Mario Uribe, a senator and the president's cousin. In the United States and Europe, on the other hand, Mr Uribe's reputation has suffered—so much so that in April Al Gore, America's former vice-president, refused to appear at the same conference as Mr Uribe in Miami.

Reactions to the killing of the hostages highlighted the widening gulf between the perceptions of Colombians and those of the outside world. The hostages were regional legislators who had been held by the FARC for five years. According to the guerrillas they died when an “unidentified military group” attacked the jungle camp where they were being held. Mr Uribe said that there were no government operations on the day in question in the area where officials believe the hostages were held.

The governments of France, Spain and Switzerland have been trying to broker an agreement under which the FARC would swap its well-known hostages, who include three American contractors and Ingrid Betancourt, a politician who holds dual French and Colombian nationality (hundreds more hostages are being held for ransom). Mr Uribe freed scores of guerrilla prisoners. But the FARC insists on the creation

of a “demilitarised zone” in which talks should take place. For Colombians, that brings back bad memories of failed peace talks from 1999-2002 in which the FARC used a similar zone for recruitment and criminal activity. Mr Uribe refuses to go down that route again.

After the killing of the 11 hostages, the three European governments condemned hostage-taking. But they also called for an international inquiry into the deaths and urged the government not to use force to rescue captives. Boosted by the demonstrations, Mr Uribe said he could not accept “statements...that measure the FARC and the government by the same yardstick”. Few things rile him more than having his democratic and human-rights credentials questioned internationally.

Yet that is happening more and more. At the end of June the Democratic leadership in America's House of Representatives announced that it would oppose ratification of a free-trade agreement with Colombia until it could see “concrete evidence of sustained results” on reducing violence, on punishing the killings of trade unionists and on prosecuting politicians with links to paramilitaries.

The Democrats did not set any precise benchmarks. But Mr Uribe is in no position to ignore such views. Since 1999 Colombia has received some $5 billion in mainly military aid from America under a plan to fight drug-trafficking and rebel groups of left and right. Until recently, this enjoyed bipartisan support in Washington. Last month, however, the House of Representatives cut the aid by $60m (to $530m) and earmarked more of the money for social and justice programmes (some of these changes may be reversed by the Senate).

All this exasperates Colombia. Mr Uribe points out that when his country was suffering its worst violence, America was unwavering in its support. That policy has now paid dividends: under Mr Uribe the guerrillas have been pushed back to remote areas and some 30,000 paramilitaries have demobilised. In the eyes of Colombian officials, the aid cut and trade snub in Washington therefore look like a case of punishing success. As for the revelations about paramilitary infiltration of politics, the officials argue that these have come to light only because of the climate of greater security in the country. And although some of the president's supporters have been found to have had links with the paramilitaries, there is no evidence that Mr Uribe himself knew of them.

José Obdulio Gaviria, an adviser to Mr Uribe, says Colombia's government will have to keep repeating its message over and over until it gets through, just as if it were dealing with “slow students”. To some degree, however, the problem is not so much the message as the messenger. In Washington Mr Uribe is paying the price for his high-handed manner, seemingly dodgy friendships and, above all, for having been an enthusiastic ally of George Bush. And even if Colombia's message does at last get through to Washington's “slow students”, the trade agreement may still fall victim to the Democrats' general lack of enthusiasm for free trade.

Mr Uribe says he cannot allow Colombia to be treated as a “servant” of the United States. But he has little choice. Outsiders might treat him with more respect if he threatened to legalise cocaine or cosy up to Hugo Chávez, Venezuela's oil-rich anti-American leader. But the latter, at least, might irritate Colombians too.

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Central America

Trading arguments

Jul 12th 2007 | SAN JOSÉ AND SAN SALVADOR
From The Economist print edition

Costa Rica's referendum on CAFTA

HE WON'T even need to change his slogan. Oscar Arias narrowly won election as president last year under the bland banner of “Costa Rica, Sí!” That embraced the main issue of the campaign: a free-trade agreement with the United States encompassing Central America and the Dominican Republic, and known as DR-CAFTA. Mr Arias championed this, but his chief rival, Ottón Solis, who lost by just 18,169 votes, opposed it. Having faced filibustering in Congress, Mr Arias wants a referendum to ratify DR-CAFTA. Now the country's courts have given the go-ahead. The referendum will be held on October 7th and Mr Arias is campaigning again: “I am the face of ‘Sí’,” he says.

Costa Rica is the only signatory country not to have ratified the trade accord, which has come into force elsewhere in Central America. The referendum will be very close fought. Opinion polls give the “Sí” camp a narrow lead, but many respondents are undecided.

Opposition to the trade deal is multi-faceted. Part of it stems simply from dislike of George Bush's United States. But some of the agreement's provisions are controversial. Unions oppose a requirement to open up to competition the country's telecommunications and insurance industries, both of which are state monopolies.

Mr Solis, a minister in Mr Arias's previous government in the 1980s, insists that he is both pro-American and not against free trade. But he says that DR-CAFTA would encroach on national sovereignty. The state telecoms monopoly may be inefficient, but its charges are low; he fears that private telecoms firms will be poorly regulated. Nearly all Costa Rica's exports to the United States already enter tariff-free under the Caribbean Basin Initiative (CBI).

Backers of the new trade agreement retort that the CBI depends on the whim of the American government and can be rescinded at any time. “The risk Solis is asking us to take is greater than that of ratifying the treaty,” says Arturo Condo of INCAE, a business school near San José. Its proponents argue that DR-CAFTA will strengthen Central America's institutions and that this is worth some sacrifice of sovereignty. Not to ratify it would be “collective suicide”, says Mr Arias.

It does not help his case that Costa Rica's economy is in many ways doing better than those of CAFTA members. In El Salvador, the first country to ratify the accord, exports are sluggish. The main exception is a lively business in re-exporting Brazilian ethanol to the United States to get round tariffs.

Another argument for DR-CAFTA is that it will help the Central Americans to get together themselves. A

customs union has long been talked of; in the “northern triangle” of Honduras, Guatemala and El Salvador, progress is being made on this. Talks on a free-trade deal with the European Union are stalled, awaiting Costa Rica's debate on DR-CAFTA. And Panama, with which Costa Rica is wrapping up free-trade negotiations, has itself concluded a similar deal with the United States.

Oddly, even Daniel Ortega, Nicaragua's left-wing president, has supported DR-CAFTA. But Costa Rica is Central America's oldest and strongest democracy. In asking the voters to decide on the trade agreement, it is setting an example to more self-important democracies elsewhere.

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Canada

Harper steps out

Jul 12th 2007 | OTTAWA
From The Economist print edition

For foreign policy, read relations

Get article background

CANADIANS knew little about Stephen Harper's foreign policy when his Conservative government took office last year, for the simple reason that he had not articulated one. They still don't know much. Since the election, foreign policy has been dominated by just one issue, that of Canadian troops in Afghanistan. Now perhaps they are about to be enlightened.

On July 15th the prime minister is due to head south on a tour that will take him to Colombia, Chile, Barbados and Haiti. An odd choice, perhaps. The Canadian foreign-policy establishment, in tune with the previous Liberal government, likes to make much of the country's mission to help Africa. And going to Colombia, rather than say Mexico or Brazil, is a brave—or some might think odd—move when its president, Álvaro Uribe, is under attack in America and Europe for his alleged disregard for human rights.

Mr Harper's answer is that Latin America is part of Canada's "neighbourhood". Two-way trade with the region is growing, and amounted to C$39 billion ($34 billion) last year—less than 5% of Canada's total trade but 15% of the portion that doesn't involve the United States. It is an important destination for Canadian investment, especially by mining firms. As for Colombia, Canadians buy its cocaine, and thus contribute to its human-rights problems. And Mr Harper's trip overlaps with a separate one by the governor-general, Michaëlle Jean, to Brazil.

Some Canadians see Mr Harper's trip as part of his general desire to be in step with George Bush. The prime minister has made smooth relations with the United States a priority. Afghanistan has become the top recipient of Canadian aid. Mr Harper's government has given outspoken support to Israel; its relations with China have been strained. Nevertheless, this week Mr Harper announced plans to purchase up to eight patrol ships for light ice-breaking duties to assert Canadian sovereignty over Arctic seaways, which is contested by the United States.

In fact, in much of this there is more continuity than change. Relations with Latin America have been getting closer since the signing of the North American Free-Trade Agreement with Mexico in 1992. It was the Liberal government which deployed combat troops to Afghanistan; while it talked of a balanced policy in the Middle East it tended to take Israel's side when it counted. And few Canadian prime ministers have allowed all-important relations with their American neighbour to deteriorate.

Perhaps the main innovation is plain speaking and the dropping of any pretence of an over-arching vision. Mr Harper's foreign-policy adviser, Roy Rempel, has argued that the myth of Canadians as the world's peacekeepers and do-gooders should yield to blunt considerations of national interest. Another interpretation is that Mr Harper has decided not to have a foreign policy, merely reacting to crises and opportunities as they arise.

This, says Adam Chapnick, of the Canadian Forces College, is in keeping with an old Conservative tradition dating back to Canada's first prime minister, Sir John Macdonald. When trade relations with the United States were debated in the House of Commons, he apparently brought two speeches with him—one in support and one opposed—and then used the one that contradicted the Liberal stand.

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Climate change in the Andes

When ice turns to water

Jul 12th 2007 | MACUSANI, PERU
From The Economist print edition

Glacial melting poses potentially costly problems for Peru and Bolivia

Get article background

FOR centuries, the run-off from the glaciers atop the spectacular snow-capped mountains of the Carabaya range has watered the pastures where alpacas graze around the small town of Macusani. More recently, the mountains have provided the town with drinking water and hydroelectricity, as well as hopes of attracting tourists to one of Peru's poorest areas. But in Carabaya, as across the Andes, the glaciers are melting fast. Their impending disappearance has large, and possibly catastrophic, implications for the country's economy and for human life.

AP

A natural regulatory system in distress

Peru is home to the world's biggest expanse of tropical glaciers. Of the 2,500 square kilometres (965 square miles) of glaciers in the four countries of the tropical Andes—Bolivia, Colombia, Ecuador and

Peru—70% are in Peru and 20% in Bolivia. The last comprehensive satellite survey by Peru's National Environmental Council, carried out in 1997, found that the area covered by glaciers had shrunk by 22% since the early 1960s. In the Carabaya range, they had receded by 32%.

Partial surveys by geologists suggest that the rate at which the glaciers are melting has speeded up over the past decade. The glacier at Pastoruri, in the Cordillera Blanca range north of Lima, shrank by more than 40% between 1995 and 2006, with the loss of ice caves popular with tourists, according to Marco Zapata, a glaciologist at the government's Natural Resources Institute. He reckons it will be gone by 2015. That is the fate that has already overtaken many smaller glaciers in Bolivia, and that of Cotacachi in Ecuador. Chacaltaya, above Bolivia's capital, La Paz, has almost disappeared; it is the site of the country's only ski resort, whose future is now uncertain.

“We are already experiencing the effects of global warming,” says Nancy Rossel, the mayor of Macusani. To those who doubt its existence, she offers to show them pictures taken ten years ago of Allinccapac, the mountain above the town, and “they can see how far the glaciers have receded.” A report by a team from the World Bank published last month in the bulletin of the American Geophysical Union (AGU), a scientific association based in Washington, DC, confirms most of the mayor's fears. It predicts that many of the lower glaciers in the Andes will be gone in the next decade or so, and that glacial runoff may dry up altogether within 20 years. It also paints a troubling picture of the future impact on water and power supplies.

One danger is that as the ice melts, newly formed lakes may send water cascading down mountainsides, triggering mudslides that are potentially lethal for the villages below. Another is that if there are no glaciers to regulate water flow, flood will alternate with drought.

That is a particular worry for Peru. After decades of migration from the Andes, two out of three Peruvians now live on its desert coast. Lima, with 8m people, is the world's second largest city located in a desert, after Cairo. Big irrigation projects have made the desert bloom and enabled an agro-export boom. Yet most of Peru's fresh water lies east of the Andes. Water for both irrigation and human consumption from the short, coastal rivers will become more irregular. The government says it needs to spend about $4.5 billion to bring domestic potable-water coverage up from its current level of 78% to the regional norm of over 90%. Billions more will be needed to divert water along tunnels beneath the Andes if glacial melting accelerates.

Another problem is that more than 70% of Peru's electricity comes from hydroelectric dams sited on the glacier-fed rivers. If their flow becomes more irregular, so will power supply. Once the glaciers disappear, Peru will have to invest $1.5 billion a year in thermal generation, according to the AGU article.

Some of these problems are common to neighbouring countries. The Bolivian Mountain Institute, an NGO, reckons that glacial melting threatens water supplies to La Paz and its satellite city, El Alto, and will aggravate existing conflicts between farmers and miners over use of the water from the marshes of the Altiplano, the high intermontane plain. In Chile, glaciers are receding at a slower rate than in its tropical neighbours. But there are worries there about the long-term impact on hydroelectric supply.

It is easier to monitor glacial melting than to remedy the problems it is likely to cause. A public debate is only just starting, led mainly by NGOs. Peru's government, faced with immediate problems of poverty and poor public services, has found it hard to focus on what seems a distant threat. However, officials have suggested that new hydroelectric schemes should be built only on rain-fed rivers to the east of the Andes.

César Portocarrero, a glacier expert with Practical Action, an NGO, argues that the first step is to encourage farmers to reduce their water use. He worries that the flow of water to Chavimochic, a large irrigation project on the north coast, could start to fall after 2020. He is also working on a plan to build small dams on mountain lakes to regulate river levels. This could work well for Macusani, because unlike the coast it enjoys a rainy season. At least such dams could help the alpacas, even if they don't attract the tourists.

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Pakistan

Showdown at the mosque

Jul 12th 2007 | LAHORE
From The Economist print edition

AFP

The bloody battle for Islamabad's Red Mosque is over. But the fallout will linger

Get article background

"SURRENDER or die" was the blunt warning given by Pakistan's president, General Pervez Musharraf, on July 7th to the Islamic vigilantes holed up in Islamabad's Lal Masjid, or Red Mosque. He was not bluffing. When last-ditch negotiations broke down in the early hours of July 10th, about 200 army commandos stormed the compound. Nearly 100 people, including a dozen soldiers and the head of the extremists, Abdul Rashid, were killed in the day-long battle. Resistance was fierce. The compound, far from being a *madrassa* housing harmless women and children, was a bunker for well-armed extremists. Some were from banned religious parties and groups, and some linked to al-Qaeda and the "Taliban" militias terrorising the tribal belt between Pakistan and Afghanistan.

The battle brought to an end a tense week-long siege, and six months in which the mosque had been brazenly defying the government. Relief that the confrontation is over is tempered with anxiety about the fallout. Many Pakistanis think the extremists had it coming. The state had to enforce its writ where it was being so criminally flouted. For such observers, religious extremism is a curse which has laid Pakistan low and must be eliminated. But there are as many who insist that the militants should have been pardoned and Muslim lives saved. Naturally, the latter camp includes clerics and conservatives.

General Musharraf's political opponents are also trying to take advantage of the bloodshed to score propaganda points. The one discordant voice has been that of Benazir Bhutto, an exiled former prime minister. She supported the storming of the mosque as a necessarily strong message to wannabe extremists. But she qualified her endorsement by arguing that religious extremism was a consequence of army rule, and only full-fledged civilian democracy could counter it effectively.

Questions have also been raised about the role of the mainstream vernacular media, print and electronic. They had given Mr Rashid an uninterrupted platform to pitch directly to Pakistanis his stark message: revolt, enforce *sharia* law and topple the Musharraf government. Middle-class journalists are typically anti-army, anti-Musharraf and anti-America.

Conspiracy theorists—and Pakistan is swarming with them—accuse the government of scripting the prolonged drama. The aim, they say, was to divert attention from its other troubles, notably the protests sparked by General Musharraf's attempt in March to sack the chief justice.

The result of the military operation has been alienation among moderates across the country and outrage among the mullahs. Liberals and NGOs are anyway opposed to military rule, and human-rights activists have attacked the “brutish” army operation. If protests against the bloodshed turn violent, the government might be compelled to resort once more to force.

The prospects of the ruling Pakistan Muslim League (PML) in a general election due in the next few months look dim. General Musharraf's plans to stay in office with all his powers intact by orthodox means look nearly hopeless. Miss Bhutto's Pakistan People's Party is convinced his supporters plan to rig the election. The voters' list, they say, has been shorn of some 20m people, mostly opposition supporters.

There may, however, be a silver lining to the Red Mosque showdown. Optimists hope it will make the army realise that it is time to end its alliance with religious forces, in place since the *jihad* against Soviet rule in Afghanistan in the 1980s. Even the army must see the dangers the jihadists pose. They have made desperate attempts to derail the peace process with India; to assassinate General Musharraf; to Talibanise the frontier regions; and now to enforce their narrow brand of *sharia* law in the federal capital by armed blackmail.

Some analysts also argue that the PML is a drag on General Musharraf's agenda for “enlightened moderation” because it constantly seeks to ally with the mullahs. This might be good news for Miss Bhutto. She has been trying to clinch a deal with the general that gives her a fair shot at the next polls. Unfortunately, the tide of political and religious extremism can probably not be stemmed by the weak, ill-disciplined political parties without the army's active help. At a conference that wound up in London this week, the opposition parties failed to agree on a policy to get rid of General Musharraf. Miss Bhutto, eyeing an end to exile, may be wise in also seeking an accommodation with him.

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Whaling in Japan

Local flukes

Jul 12th 2007 | TAIJI AND WADA
From The Economist print edition

Whaling matters to some places in Japan, but is hardly a national tradition

Get article background

IN THE harbour town of Taiji people have family names like Kaji (literally, ironsmith), Tomi (look-out) and Amino (net): you get the idea. Taiji has been organising whale hunts ever since locals made breakthroughs 400 years ago in harpoon technology and in the use of nets to slow down whales migrating along this rocky coast. Yoji Kita, a town official, pulls out an Edo-era (1603-1868) painting that shows villagers at sea using ladders to scale a slaughtered right whale. Mr Kita's own great-grandfather was one of the few survivors of a village catastrophe when, at a time of great hunger, most of Taiji's men went out in pursuit of a right whale and her calf, and an offshore storm blew up. On this coast old stone monuments appease the spirits of dead whales.

Reuters

Whale-wading in Wada

Most parts of the world may have abandoned it, but whaling continues in Taiji and in Wada, east of Tokyo. In each port float a brace of fast, efficient whalers. Throughout the summer, Wada brings in 26 Baird's beaked whales, measuring around ten metres (33 feet). These are cut up on the town slipway and their meat sold at dawn to housewives and local traders. In Taiji a hunt for short-finned pilot whales begins in September. The town also has regular dolphin culls. The animals are herded into a particular cove and slaughtered (with some spared and sold at high prices to aquariums). The dolphin-killing outrages Western environmentalists, who Mr Kita says come to Taiji to get moral kicks at the expense of locals' long-established ways (though some Taiji folk admit to discomfort about the slaughter).

Coastal whaling for smaller cetaceans falls outside the purview of the International Whaling Commission (IWC), which manages whale stocks (though, perversely, minke whales, which are managed, are smaller than Baird's beaked ones). In 1986 a moratorium went into effect on most types of whaling, to protect devastated stocks. At the commission's annual meeting in May, Japan threw a hissy fit when its request for the resumption of coastal whaling for bigger species was turned down. As it is, Japan kills hundreds of larger whales each year, mainly in Antarctic waters, in the name of “research”, which is allowed under IWC rules. A number of the crew on the long-distance whalers come from Taiji and Wada, whose supermarket shelves are laden with whale meat. Children eat it once a month at local schools. If you like your beef nicely greased and on the chewy side, you would probably like whale.

Whaling shapes the way a handful of communities such as Taiji and Wada see themselves, but right-wing politicians from the ruling Liberal Democratic Party (LDP) claim that restrictions on it are an attack on Japan's national identity. This is overdoing things. The boom in consumption came only with the American occupation after the second world war, when whale meat was a cheap source of protein for a

malnourished country. That hastened the collapse in whale stocks, which led to the moratorium.

Since then, consumption of whale (and dolphin) meat has dropped sharply, partly because of the moratorium, and partly because health concerns have grown. Some whale meat has levels of environmental toxins (including mercury) that some scientists say are dangerously high, particularly for children and pregnant women. Mr Kita admits to the problem in Taiji's dolphins, whose internal organs are not sold for consumption. You might think the LDP would be looking into such health concerns. But politicians are too busy huffing and puffing about leaving the IWC so Japan can go a-whaling at will.

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NATO in Afghanistan

No rush for the exit, yet

Jul 12th 2007 | KABUL
From The Economist print edition

But an orderly queue is forming

Get article background

BRINGING peace and development to Afghanistan was always going to be, as Britain's ambassador has put it, “a marathon not a sprint”. The resurgent Taliban is betting that the countries sending troops to the NATO-led International Security Assistance Force (ISAF) do not have the stamina for it. In some, the steady drip of depressing news of casualties among their own soldiers and Afghan civilians is wearing away whatever support the troop deployments ever had. Governments, even those whose “caveats” ensure their troops are kept out of the most serious fighting in the south, are finding Afghanistan a political millstone. The coalition is not crumbling; but there are worries about whether it can stay the course.

America still provides nearly half the 37-country ISAF's 35,500 soldiers; Britain, the next biggest contributor (see table), will have sent around 7,500 by the end of the year. France's new president, Nicolas Sarkozy, said during the election campaign earlier this year that he does not want to keep French troops in Afghanistan indefinitely, but has since said that withdrawal is not “imminent”.

Coalition of the unwilling?
ISAF mission in Afghanistan, troop numbers
May 2007, '000

United States	17.0	Italy	2.0
Britain	6.7	Turkey	1.2
Germany	3.0	Poland	1.1
Canada	2.5	France	1.0
Netherlands	2.2	Others	5.0

Source: International Security Assistance Force

In Canada, however, all three opposition parties are calling for the military part of the country's mission in Afghanistan to wind up in February 2009 at the latest. The army is deployed in Kandahar, a dangerous southern province. Next month French-speaking Québécois forces will take over, bringing a higher risk of casualties to the Canadian province in which opposition to the mission runs highest.

Stephen Harper, the prime minister, at the end of last month subtly shifted his own position. Whereas before he has hinted at extending the mission beyond February 2009, he now says that any extension will be put to a vote in parliament. As things stand, it would be defeated. Yet even NATO's most optimistic commanders think it will not be until 2010-11 at the earliest that Afghan security forces are ready to take over.

Six Canadian soldiers were killed on July 4th, bringing to 22 the number killed this year, and further eroding public support for the deployment, which has in any event been below 50% for the past year. The government has commissioned research on how to sell the mission to sceptical Canadians. It has to counter a powerful legend that, since the second world war, its army has been a peacekeeping operation not a fighting one, and that Afghanistan has sullied this noble ideal.

Similarly, in Germany, where even today there is squeamishness about seeing the country's soldiers going into action, Afghanistan is a huge political issue. The troops have been deployed in the north of the country, away from the fiercest fighting. But the army has lost 21 soldiers, bringing home to the public that in combat there are no halfway houses: assisting one side means becoming a target and needing, at times, to strike first.

There are in fact three German missions (“mandates”) in the country: a commitment to America's “Operation Enduring Freedom” (OEF); the deployment of six Tornado fighters for reconnaissance (approved by the constitutional court, despite fears that it broke the constitutional commitment to non-aggression); and the contribution to ISAF. The role in ISAF is not in doubt; but more and more MPs from the Social Democrats (SPD) are against the renewal of the OEF mandate, which comes up for parliamentary debate in November.

Like Germany's, Italy's soldiers in Afghanistan are not in direct combat roles. Even so the deployment has been a source of continual discomfort to Romano Prodi, the prime minister, who offered to resign in February after his government lost a vote in parliament on foreign policy, and particularly the Afghan mission. (Mr Prodi kept his job after the president rejected his resignation.) The soldiers have recently been given some smart new kit: helicopters, tanks and armoured cars. But the defence minister has insisted that this is simply to defend them from insurgent attacks, not a sign that Italy is to bow to pressure from NATO allies to take on a combat role.

Dutch troops were until recently spared the worst of the violence. But last month two soldiers died in combat, and this week eight were wounded in a suicide attack in the central province of Uruzgan. This is awkward for a government that has to decide in the next few weeks whether to stay in Afghanistan beyond 2008. The defence minister has said it has a “political intention” of doing so. He then had to apologise for a “slip of the tongue”—it was bad form to announce such a plan before a parliamentary debate due after the summer.

If NATO's old guard has troubles with public opinion, its new recruits seem positively gung-ho. Poland has a reinforced battalion of around 1,000 in Paktika, a dangerous province that borders the Pakistani tribal areas. Hungary has sent several companies to Kandahar, where they will be joined by a Bulgarian contingent. Estonia has had a small force of around 100 fighting in Helmand with considerable credit for the past year.

That these various eastern European powers have been so willing to shoulder the burden seems to stem from their greater enthusiasm for NATO as an institution. The desire to see NATO succeed in the new role it is carving out for itself outside Europe probably stems from greater interest in its old role—providing a shield of mutual defence in Europe at a time when they feel an increasing pressure from Russia.

Some of them also seem more willing to accept that there is a war in Afghanistan. Some Western governments, portraying their Afghan missions as humanitarian reconstruction efforts, find it hard to justify the deaths of their soldiers.

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Housing in Beijing

One household, one vote

Jul 12th 2007 | JIUXIANQIAO
From The Economist print edition

A novel approach to conflict-resolution

Get article background

RETIRED workers who once made everything from nuclear-bomb components to wireless equipment are now living miserably in cockroach-infested slums in this corner of north-east Beijing. Many of them are also disgruntled with the compensation offered by developers who want to move them out. Disputes over relocation are rife across China, but this one is stirring a broader debate: about the meaning of democracy.

Dashanzi is a well-known trendy part of the capital, where avant-garde artists have set up studios in the abandoned factories that once formed the proud hub of China's military-electronics industry. Far less visited is Jiuxianqiao to its south, where the workers lived. Their blocks of flats, built by the Russians and East Germans in the 1950s, were once among the best in Beijing. These days, the 20,000 former workers and family members who still live in them mostly agree that housing in Beijing does not get much worse.

But they cannot agree on a common approach to the developer that wants to knock down their buildings and, reportedly, to build them new ones, as well as luxury-apartment blocks. The company will give them new flats free of charge, and cash to tide them over until these are built. Some residents say the offer is inadequate. Others, desperate to leave the cramped barrack-like buildings, where kitchens and lavatories are often shared between families, are happy to take it.

For the first reported time in the fractious history of China's recent urban makeover, residents on June 9th had a chance to vote on the offer. A month later state-owned newspapers are still poring over that event. Some called it a referendum, a term not used lightly in China. Under the Communist Party there should be no need for referendums since the party represents the will of the people. The party's dim view of this technique is evident in its dealings with Taiwan (see article).

Ba Changrui, deputy party chief of Jiuxianqiao, which includes the slums as well as Dashanzi and its now arty factories, says he is angry with the Chinese media for portraying this as a referendum. It was, he says, merely a way of canvassing public opinion. The result imposed no obligations on the developer. In any event, it was not clear-cut: 44.8% of households voted in favour of the offer and 22.4% against, and the rest did not vote at all. But Mr Ba's denials have not stopped a torrent of media comment, some of it pasted by residents on outdoor walls.

Many Jiuxianqiao residents are long-term tenants rather than owner-occupiers. A wave of property privatisation in the late 1990s passed the area by because of the difficulty of dealing with the shared facilities. Many press articles have nevertheless denounced the use of a referendum to decide the fate of individuals' private property. Property rights, argued one commentator, were a “core human right” that could not be taken away by democracy.

But as the *Legal Daily* noted this week, democracies could tamper with property rights by imposing taxes. And to say that a referendum was a tyranny of the majority was a misunderstanding. “Modern democracy also means protecting the minority,” it argued. Democracy can also be confusing. In Jiuxianqiao a simple majority has approved the developer's offer. But no one knows what to make of that. As those with more experience of ballots could have told them: voting is the easy part.

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The European Union and Taiwan

Bully for China

Jul 12th 2007 | BRUSSELS
From The Economist print edition

China tells the EU to dump on Taiwan. The EU asks "How hard?"

Get article background

ASK officials in Brussels about relations between China and the European Union, and you will soon hear the word "values". A recent EU strategy paper on China calls on Europe to pursue a "dynamic relationship with China based on our values", notably including democracy and human rights.

Try telling that to Taiwan. It is about to receive a stern EU injunction to act "sensibly and responsibly" by scrapping a planned referendum asking voters whether they would like the island to seek membership of the United Nations under its historic name, the "Republic of China", or just "Taiwan".

Why is the EU meddling? Taiwan is a thriving democracy and big trading partner (almost as important as India or Brazil). The explanation is simple and unedifying: the EU is doing China's bidding. Chinese rulers regard the Taiwan referendum as a sneaky step closer to an eventual declaration of formal independence by the island.

China expends extraordinary energy on pestering other governments to preserve the strange limbo inhabited by Taiwan, a self-governing island of 23m that it insists is a wayward province. Whenever Taiwan irks China, its ambassadors appear at foreign ministries worldwide, demanding that Taiwan be rebuked.

An internal EU memorandum sheds light on the way such strong-arm diplomacy works. Prepared by officials working under Javier Solana, the EU's foreign-policy supremo, it describes a meeting, late last month, between the Chinese ambassador to the EU, Guan Chengyuan, and a top Eurocrat. According to EU note-takers, Mr Guan called the referendum provocative and destabilising, and said China wanted EU support, as it did not want to have to use "the last resort"—an apparent reference to its threat to use force, if necessary, to "reunify" Taiwan.

The memorandum records Mr Guan's EU host as agreeing that a referendum is against Taiwan's own interests, and offering to send a "clear and forceful" message to Taipei to that effect. America, which has many reasons to seek China's diplomatic goodwill, has publicly rebuked Taiwan over the referendum. The EU, in contrast, will stick to private warnings for the moment, to avoid "playing into the hands" of Taiwan's "populist" president, Chen Shui-bian, by giving him "undesirable" publicity.

Portugal, which took over the six-month rotating presidency of the EU this month, has duly drafted a private warning to Taiwan, saying that a referendum risks raising tensions and would be "unhelpful". A parallel message is to be sent to China, urging restraint.

UN membership for Taiwan is a long-lost cause, and Mr Chen's referendum plan is at heart an electoral ploy ahead of next year's presidential poll. But that is the sort of thing that happens in a democracy. One dissenting EU diplomat says the Union is pretending there is "moral equivalence" between Taiwanese election politics and Chinese threats of violence. Certainly, this is not how most people understand the EU's oft-professed values.

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Dengue in South-East Asia

The prosperity bug

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From The Economist print edition

The dengue mosquito is one of globalisation's winners

SEASONAL rains sweeping across South-East Asia are bringing a surge in dengue fever. Hospitals from Yangon to Manila are filling with cases. Indonesia, whose rains come earlier, has had almost 100,000 confirmed dengue cases and around 1,000 deaths. Cambodia has so far had almost 15,000 cases and over 180 deaths—more than in all of 2006—and its outbreak may not yet have peaked. Malaysia, Vietnam and Thailand have each had over 20,000 cases, though their efficient health services have kept death rates low. Singapore, the region's richest country, has a sophisticated dengue-control programme, with house-to-house inspections—yet its infection rate is still rising. Regionwide, this year's toll could be at least as bad as 1998, the worst on record.

As the region has modernised, deaths from other infectious diseases, from malaria to measles, have fallen. But rising prosperity and globalisation have given a boost to *Aedes aegypti*, the mosquito that carries dengue (and yellow fever). As commercial shipping expanded worldwide in the 18th and 19th centuries, *Aedes* was a stowaway, possibly from Africa. By the early 20th century dengue was endemic across the tropics. Globalisation provides ever more opportunities for mosquitoes and infected humans to carry the disease by land, air and sea. Many people infected with dengue suffer only mild symptoms and do not know they are carrying it.

Malaria (passed on by a different sort of mosquito) strikes poor, rural folk living near forests or swamps. But *Aedes* and the virus it carries have adapted well to city life. The four types of dengue virus, none of which confers immunity to the rest, spread faster in densely populated areas. So migration from countryside to city—both a cause and an effect of South-East Asia's rising prosperity—has made it more prone to dengue. *Aedes*'s larvae thrive in tiny pools of rainwater and cities may have more of these than traditional villages: guttering, potted plants, even upturned bottle-tops. Global warming is helping the mosquito breed faster.

Professor Goh Kee Tai of Singapore's health ministry says only 1-2% of homes visited by his inspectors have *Aedes* larval infestations, down from perhaps 50% in the 1960s. Yet each outbreak seems bigger than the last. The dynamics of the disease are complex: a few disease-free years means the birth of a new batch of children who lack immunity and thus provide a fertile breeding-ground for the next outbreak.

As with malaria, a vaccine against dengue still seems some way off, says John Ehrenberg of the World Health Organisation. But unlike in the case of malaria, little progress has been made in finding effective treatments. Dengue still takes its greatest toll among the poor, who are less likely to get help when it leads to a potentially deadly “haemorrhagic” fever.

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South Korea's presidential election

Glorious mud

Jul 12th 2007 | SEOUL
From The Economist print edition

Nothing quite like it for winning a South Korean election

Get article background

THE rainy season is upon South Korea, and with it the first splashes of what is likely to be a torrent of mud before December's presidential election. They have bespattered Lee Myung-bak, who leads in the opinion polls. Mr Lee, once Seoul's mayor, is under investigation for allegedly tipping off his brother-in-law about some land he bought that became the site of a high-rise development. His wife also faces allegations about property speculation. It has emerged that she has changed address 15 times. Mr Lee has denied any wrongdoing.

A member of the main opposition Grand National Party (GNP), Mr Lee has enjoyed a clear lead over his GNP rival, Park Geun-hye, daughter of Park Chung-hee, a military dictator assassinated in 1979. Prospective candidates from the ruling Uri party of Roh Moo-hyun, the president, lag far behind the opposition. But the investigation into the family's business dealings has already cut Mr Lee's approval rating, once over 50%, to below 40%. Uri officials can barely contain their glee as the allegations make front-page news.

Indeed, Mr Lee's supporters accuse the Uri party of orchestrating the smears. They say information on property deals could only have come from confidential official documents. The Uri party sees Miss Park as an easier candidate to beat, because of her lack of business experience and bad memories of her father's rule.

Observers in Seoul suspect that the allegations against Mr Lee may be part of an orchestrated deluge against him leading up to the election of the GNP's official candidate on August 20th. If Mr Lee wins, many expect the deluge to intensify, with damaging accusations about his tenure as mayor of Seoul and as boss of Hyundai Construction and Engineering, a leading building firm, where he worked under Chung Ju-yung, the firm's late founder. Mr Chung, a billionaire and presidential candidate himself in 1992, was a leading architect of rapprochement with North Korea.

In the previous election, smears directed at the GNP's candidate helped the Uri party win. This year, thanks to Mr Roh's ineffective rule and abysmal approval ratings, the party faces an uphill battle. It might take a lot of mud to convince voters they do not want a clean break.

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Indonesia

The end of the rainbow

Jul 12th 2007 | JAKARTA
From The Economist print edition

Prosecutors chase a pot of Suharto gold

Get article background

IT IS the latest attempt to claw back some of the ill-gotten gains allegedly amassed by Suharto, Indonesia's former dictator, now aged 86. On July 9th prosecutors filed a $1.5 billion civil suit against him and one of the myriad charities he founded. They allege that for 20 years the retired general, who was toppled in 1998 after 32 years in power, forced state banks and others to plough hundreds of millions of dollars into the Supersemar Foundation. Much of this money, rather than being used for promised social work, was allegedly siphoned off to companies run by members of the first family and their cronies.

In Indonesia the suit was greeted with bored scepticism. Few expect Mr Suharto to lose even this small part of his rumoured fortune. Debate focused more on which bit of the chronically corrupt legal system will yield to pressure to ensure a Suharto victory.

AFP

Poor old bloke

Cynicism is understandable. Efforts to prosecute Mr Suharto for corruption foundered in 2000, when doctors declared him unfit to stand trial. His youngest son, known as “Tommy”, is the only one of his six children to be convicted of corruption (and, later, of having one of the judges murdered). Mr Suharto's half-brother and his golf partner have both been briefly and comfortably jailed for misusing money from a government reforestation fund.

The cynicism, however, might be misplaced. On July 10th the attorney-general's office announced it would soon prosecute Tommy for allegedly embezzling money from the nation's clove-management agency. Lawsuits against at least six other Suharto foundations are also being considered.

Until money has been recovered and Tommy's siblings take their turns in the dock, Indonesians will not believe the government is committed to taking on the Suhartos. But Susilo Bambang Yudhoyono, the Suharto-era general who is the current president, is almost certain to seek re-election in 2009. Fighting corruption was one of the main themes of his first campaign in 2004. After a bumpy time last year, in May he replaced his attorney-general and justice minister. They know that successful prosecutions would win him votes.

With so few big fish being netted, anti-corruption activists want the burden of proof in corruption cases reversed: ie, wealthy people like the Suhartos should be forced to show that their gains are not ill-gotten. Mr Yudhoyono is apparently open to the idea; but not so parliament, which would have to change the law. Few of its members are thought to favour a process that might put their own affairs under much greater scrutiny.

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Iraq

The bloody stalemate persists

Jul 12th 2007 | ARBIL
From The Economist print edition

EPA

As a military and political deadlock prevails, the mayhem continues

Get article background

WHILE George Bush argues for giving his troops more time to bring a modicum of security to Iraq, the bombs seem to get more lethal. The one that went off on July 7th in the market place of a little farming village north of Baghdad called Amirli, populated mainly by Shia Turkomans, was one of the bloodiest since the American invasion four years ago. It was said to be hidden in a lorry piled with farm produce, a common means of concealment. The shops were crowded with Saturday shoppers. At least 160 villagers, many of them women and children, were killed.

The perpetrators of such attacks rarely claim them, though American and Iraqi officials usually blame a network of radicals linked to al-Qaeda or other like-minded *takfiris*, Sunni puritans who deem Shias to be apostates. Local officials in Amirli said that the network's fighters were fleeing north from an American offensive in the neighbouring province of Diyala, causing havoc as they went. Fugitive militants also briefly seized another remote village as they headed out of the targeted areas, according to American soldiers.

To the west of Baghdad, in Anbar province, which a year ago was the most dangerous theatre for American troops, local tribal sheikhs seem to have persuaded people to turn against al-Qaeda in the area, with the result that American losses there have fallen sharply. Does this, and the grim spectacle of massive bomb attacks on villages that had hitherto escaped the violence affecting much of central Iraq, suggest that the local networks that give allegiance to al-Qaeda are at last on the wane?

Probably not. If al-Qaeda militants are indeed fleeing north, it is likely to be another example of the “whack-a-mole” syndrome: guerrillas who are thumped down in one hole promptly pop up again from another. Though the surge of American reinforcements into Iraq, ordered by Mr Bush, was completed in mid-June, the 160,000 American troops now there are still too few to suppress the insurgents across the country, most of whom have no link to al-Qaeda and show no sign of giving up. Iraq's homegrown forces are still too badly motivated, too lacking in national as opposed to sectarian spirit, too skimpily trained and too badly equipped to keep the peace on their own.

For sure, the surge has had some modest, patchy success. The Iraqi government says that by last month violent deaths of civilians had dropped by around a quarter since February, when the surge began. But such claims are hard to verify. By other estimates, the number rose again in May and June after an initial

sharp drop in sectarian killings, though not to January's rate. What is clear—and more telling from the point of view of the American public—is that the quarterly toll of American military deaths from April to June was the highest since the war began four years ago.

In any event, the Americans have long acknowledged that military action on its own will not make Iraq a viable country. The American army's aim is to “hold the line”, granting a breathing space for Iraq's politicians to reconcile themselves, including representatives of the Sunni Arab insurgency not linked to al-Qaeda.

But political progress has been dismal. Even a much-aired oil bill, meant to convince the Sunnis that they will get a fair share of oil wealth, is stuck. The prime minister, Nuri al-Maliki, announced earlier this month that his cabinet had finally approved it for reading in parliament the next day. But then a block of Shia MPs loyal to a radical cleric, Muqtada al-Sadr, said they would reject the law for taking too much power from central government and giving it to the Kurdistan region. Then Kurdish officials said they had yet to see the law's final draft but suspected it would give the federal government too much. Then the main block of Sunni MPs, who had been boycotting parliament for an unrelated reason, insisted that it could not be read in its absence. So the reading is likely to be postponed again. Some suspect that Mr Maliki, who has been under constant American pressure to find a consensus on oil and other divisive issues, put forward the bill just to show there is no consensus.

Thanks both to the country's dire insecurity and the political impasse, Mr Maliki's government looks weaker than ever. His own Dawa party has long been disadvantaged by its lack of a powerful militia of its own. Some Sunni politicians may be preparing to hold a no-confidence vote against him, perhaps with the tacit backing of the American vice-president, Dick Cheney, who is said to favour an alternative Shia leader as prime minister. The Sadrists may propose a no-confidence motion too.

To muddy the waters still more, bitter rivalry persists between the Sadrists and Mr Maliki's other Shia ally, the Supreme Islamic Iraqi Council (formerly the Supreme Council for Islamic Revolution in Iraq, better known by its acronym, SCIRI). At least Mr Maliki still has good relations with the Kurdish parties, thanks to his promise of a referendum by December that could pave the way for the disputed province of Kirkuk to join Iraqi Kurdistan. But even that is not certain to happen.

Can't they agree about anything?

Moreover, though Sunnis and Sadrists are united against the oil law and oppose the holding of a referendum on Kirkuk, they disagree bluntly on several other big issues. For instance, the Sadrists strongly oppose the idea of softening the government's deBaathification policy to let more Sunni Arabs, who predominated in Saddam Hussein's Baath party, back into the civil service and the armed forces; in Sadrist eyes, the Baath party is evil incarnate. The Sadrists are also dead against disarming the Shia militias (especially their own) that have been responsible for butchering so many Sunni civilians in the past year.

However, despite rumours of Mr Cheney's machinations, the American administration has given no hint that it is seeking to replace Mr Maliki. It may change its mind if, perhaps by the new year, he has still failed to enact laws to accommodate disenchanted Sunnis over oil and such issues as the creation of federal “super-regions” which many Sunnis see as leading to Iraq's fragmentation. Mr Maliki has made compromises in the past, notably with the Kurds, and his leading critics among the Sunnis and Sadrists have themselves failed to produce alternative legislation that could help reconcile the country's competing groups. Earlier this year he managed to replace a clutch of Sadrist ministers, some of whom had used their ministries as militia bases, during a protracted argument over whether to set a deadline for the withdrawal of American troops.

Some governments in the region, in particular Saudi Arabia, which detest Mr Maliki for his alleged sectarian bias, have floated the idea of bringing back Iyad Allawi, a secular-minded Shia who led Iraq's government from 2004 to 2005. But he is hated by the Sadrists, who have the largest following of any of the Shia blocks, and is widely distrusted, especially by the Kurds.

So Iraq is stuck in a military and political deadlock. American generals on the ground continue to urge patience. This week the overall commander, General David Petraeus, again noted that “the average counter-insurgency is somewhere around a nine- or a ten-year endeavour”. On the same day as the bomb in Amirli, he said he expected the insurgents to launch a series of sensational attacks, staging a “mini-Tet”—a reference to the offensive by the Viet Cong in 1968 that is often said to have persuaded the

American people that the Vietnam war was unwinnable. The general is to present his assessment of the Iraq war to Congress in mid-September. But on present trends, he may not be given more than half a year to turn things round.

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Zimbabwe

How to stay alive when it all runs out

Jul 12th 2007 | HARARE
From The Economist print edition

Ordinary Zimbabweans find creative ways to survive

Reuters

Get article background

AT FIRST glance, life in Harare appears surprisingly normal. Cars still cruise along the streets, shops are still open, children wear neat school uniforms, and men and women in suits still talk on mobile phones. Yet in Zimbabwe appearances are deceptive. The economy is collapsing. Eight in ten people have no formal jobs; inflation, officially estimated at more than 3,700%, may actually be twice as high.

So President Robert Mugabe has decided to try to do something about the galloping prices of basic goods. Ignoring protests from Gideon Gono, the governor of the central bank, Mr Mugabe, who famously despises “bookish economics”, has sent the police in to order shopkeepers to slash their prices, forcing them to sell at a loss. The predictable result is huge crowds waiting outside shops to rush in and grab whatever they can while the going is good. Factories are threatened with being taken over if they stop production. Hundreds of shopkeepers have been arrested, accused of not lowering their prices enough.

So basic goods such as cooking oil, soap and meat have disappeared from the shelves. At a supermarket in the Fife Avenue shopping centre, expensive imported goods are still on sale but the meat counter is empty and there is no bread. Luckily, there is a bit of cooking oil. Each bottle costs about one-third of a teacher's monthly wage and shoppers are allowed to buy only two bottles each. A woman pushing a trolley says she spends a good part of the day going from shop to shop to find basic items such as sugar or flour.

Petrol, which was expensive but available after private importers were licensed, has now dried up as well, thanks to the enforced price cuts. At a petrol station in one of Harare's leafy suburbs, a line of over 80 cars snakes around the block, overseen by a few policemen and soldiers. Without much petrol, public transport, whose fares have also been slashed, has become too scarce for commuters. On one of Harare's main avenues, crowds wait by the side of the road at night, hoping for a ride home. Some people run after a pick-up truck that is already full, trying to jump on. It can take hours to get to work in the morning.

Yet most things are available on the black market—for those who can afford them. At night, you only have to drive to the right spot and young men rush over to offer petrol at more than eight times the official price. In the poor district of Mbare, about 3km (two miles or so) from Harare's centre, a few people are selling cooking oil and sugar at the side of the road; some carry bags of maize flour on their heads. But police raids this week have pushed this black market even further underground.

Twenty kilometres outside Harare, a 40-year-old teacher explains that she cannot survive on her monthly earnings of 1.9m Zimbabwean dollars, equivalent to $7,600 at the official exchange rate but only $7.60 on the black market. Her husband makes even less. She walks 5km to work every day only “because there is nothing else to do”, but some of her colleagues no longer show up at all. She grows vegetables in her back yard; the greens, she says, are “our chicken and our pork, our eggs and our beef”.

Scraping by

There is no running water for most of the day, so she fills buckets and bottles whenever taps work and has to boil the water as it is no longer safe to drink. Electricity is also scarce, so she cooks on a wood fire in her back yard and buys candles whenever she can afford to. She wears a worn-out anorak and woollen hat in her small house, as she cannot afford heating to fight the biting winter cold. To feed and school her three children, she borrows money to buy a few things, then goes to South Africa or Zambia to sell them.

Many people survive by trading. A 34-year-old professional, who has left his job to become a middleman, buys foreign exchange on the black market and imports all kinds of stuff, from IT equipment to stationery. He then resells at a fat mark-up to local companies that cannot risk breaking the foreign-exchange laws. When not driving to South Africa, he lounges in his drawing room watching satellite television on a wide screen. He says he makes a profit of more than $5,000 a month; he lives in a nice residential area where electricity and water are always on.

There is plenty of foreign exchange, he explains. The lucky few with access to American dollars at the official rate of 250 Zimbabwe dollars to one American greenback are making a killing selling them on the black market, where the rate is about 250,000. Getting enough local cash has become the main hurdle since restrictions were placed on withdrawals. To get around the Z$1.5m daily limit, people open multiple bank accounts or pay a 10% premium to get cash against a bank transfer.

Choked by hyperinflation and arbitrary restrictions, people have become increasingly creative to survive. More than 3m have emigrated, mainly to South Africa, while a small elite bleeds the economy dry. A local businessman says the system will collapse in six months—and that Zimbabwe, under new management, will become Africa's fastest growing economy. “Then again”, he smiles, “we have been saying this for years.”

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Ethiopia

Off with their heads, maybe

Jul 12th 2007 | NAIROBI
From The Economist print edition

Will the political dissidents be spared?

EARLIER this year, Ethiopian courts released many of the country's most important political dissidents from the grim Kaliti jail on the outskirts of Addis Ababa. They had been there since they were rounded up by police following opposition protests (in which 193 people were killed) against flawed presidential elections in 2005. In another promising sign of reconciliation, charges against the 38 remaining defendants were reduced from treason and genocide to “outrage against the constitution” and “incitement to armed rebellion”.

AFP

Berhanu Nega, mayor of Addis Ababa, awaits his fate

So it was a real shock this week when the state prosecutor called for all 38 to be put to death. Those facing the firing squad include Hailu Shawel, the elderly head of the Coalition for Unity and Democracy (CUD), the main opposition party, and Berhanu Nega, the elected mayor of the capital, Addis Ababa.

Surely not, say queasy diplomats, aid types and even many in the Ethiopian government. The prime minister, Meles Zenawi, has made some progress in building infrastructure, tackling poverty and attracting foreign investment. He has even managed to turn himself into a close ally of America by invading Somalia last December to vanquish the Islamist regime in Mogadishu, suspected of harbouring al-Qaeda people. The last thing Mr Zenawi needs now is the terrible publicity, especially in America, that such executions would bring.

The judge adjourned sentencing until later this month. Even if a death sentence is handed down, a carefully worded apology by the dissidents could let them walk free. Mr Zenawi would probably go along with that. There is now almost as much that unites the government and the opposition as divides them. Some back his invasion of Somalia; many others agree on the threats posed by Eritrea, Islamist terrorism and separatist groups within Ethiopia.

But Ethiopians are stubborn. Most of the 38 dissidents have refused even to recognise the court's legitimacy or to offer a defence. They may be unwilling to sign an apology. Then there is the government's instinct for brutality. In spasms, it has muzzled, beaten and jailed the opposition since the elections of 2005. Thousands of young Ethiopians were sent to prison camps. The press has been stamped on.

All of this puts the United States in a quandary. Ethiopia, despite its human-rights record, is a key ally against terrorism. America backed Ethiopia's invasion of Somalia. Now it is pressing Mr Zenawi urgently to let the dissidents go free.

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The Comoro islands

An unusual haunt for al-Qaeda

Jul 12th 2007 | N'TSAOUENI
From The Economist print edition

A visit to the island home of America's most wanted man in east Africa

Get article background

ON JUNE 2nd an American destroyer, the *USS Chafee*, fired its guns on a remote bit of northern Somalia's coastline. Somali sources say the attack killed several foreign Islamist fighters. Exactly how many, and who they were, is unclear. One target was said to be Fazul Abdullah Muhammad, a 35-year old citizen of the Comoro islands. But then again, Mr Fazul is mentioned as the target of just about every American military action in Africa. He is America's most wanted in east Africa.

Intelligence sources say Mr Fazul is the head of al-Qaeda in east Africa and intelligence chief for the *Shabab* (meaning "young men"), a Somali jihadist group intent on fomenting a holy war with "Christian" Ethiopia (which in fact has an almost equally large Muslim population). The original *Shabab*, larger but less fierce, had been smashed to pieces by a joint offensive by Ethiopian, Somali-government and American forces in December and January. Its remnants have since regrouped under Mr Fazul's influence, carrying out suicide attacks, setting off roadside bombs and using other tactics copied from Iraq.

Mr Fazul has quite a history. The FBI thinks he helped mastermind the bombing of the American embassy in Nairobi, Kenya's capital, in 1998, killing 240 people. After several years in hiding, including a stint teaching under an alias at an Islamist school in Lamu, off Kenya's coast, he is thought to have planned an attack on a hotel in Mombasa in 2002, which killed 15 people, along with a failed attempt to shoot down an Israeli passenger aircraft at Mombasa airport. His movements thereafter are sketchy, though he has probably spent most of his time in Somalia, protected by conservative clerics and tribal elders. He has a $5m bounty on his head.

Mr Fazul is in the eye of the storm. A determination to bring him to justice is one reason America backed Ethiopia's recent invasion of Somalia. In return for American intelligence and air support, Ethiopia would do all it could to hand over Mr Fazul, dead or alive. But Mr Fazul remains at large and Mogadishu is even less safe than it was before.

Infographics

Mr Fazul's reputation has risen, not least because of the American intelligence agencies' habit of granting

him superhuman qualities. He has been variously described as a hand-to-hand fighter, a bomb-maker, a computer expert, a linguist, a master of disguise (with a fondness for baseball caps), a one-time bodyguard of Osama bin Laden and a strategic thinker with the ear of jihadist financiers in the Middle East.

The truth may be more mundane. Mr Fazul is doubtless a sharp and resourceful terrorist. He is also short, shy and no more of a linguist than most of his countrymen, many of whom speak French and Arabic as well as their native Comorian, which is close to Swahili, east Africa's lingua franca; the islands lie some 200 miles (322km) off the continent's east coast (see map).

It was all so cosy back home

Mr Fazul's sister lives down an alley in Moroni, the Comoros' modest capital on Grande Comore, the main island. She wears Western clothes, sun-glasses and make-up. Mr Fazul's mother runs a kiosk around the corner. She often sits out on the veranda with her grandchildren, including several of Mr Fazul's own young ones, who returned to the Comoros with their mother in May, after a spell in an Ethiopian jail. Their mother had taken them to Somalia to meet their father but, says the family, the reunion never happened: “He called her and said it was too dangerous.” Mother and children were caught by the Kenyan authorities trying to flee across the border into Kenya.

As a boy, Mr Fazul was good at mathematics. He applied for a visa to study in France, which has a large Comorian community, but was turned down. Instead, his family put some money together for him to study computing in Pakistan. His father was a respected builder of modest means; there may be truth in the local rumour that Mr Fazul was first attracted to al-Qaeda by the promise of a pay cheque to send home.

Mr Fazul's sister describes him in the same way his childhood friends and acquaintances do: “Very quiet, very gentle, very clever.” If he did carry out the bombings he must, she says, have had a reason. Such as? “Palestine, maybe.” She says she has not seen him since 1998, just after the Nairobi bombing. “Do you know where he is?” she implores. Mr Fazul's mother is harder to read. “We paid for his education,” she says bitterly, “and got nothing, not a penny. He didn't even turn up for his father's funeral.” Neighbours say that Mr Fazul's father had a heart attack when he learned the extent of his son's troubles.

Despite endemic corruption and a score of coups, failed and successful, since independence in 1975, the Comoros have little crime. Most of the 800,000-odd islanders are easy-going Sunni Muslims. Public execution is on the statute book but rarely carried out. Alcohol is easy to get. Few women are veiled; they squeeze into shared taxis with men, buttock to buttock.

And non-Islamic superstition persists: mosques are said miraculously to build themselves at night, sulphurous crater lakes serve as wishing wells, and witch doctors, more influential than most mullahs, are paid to cast or remove spells. There is no apparent desire for martyrdom. The more pressing concerns are jobs, political stability, volcanoes and the practice of *grand mariage*, when families hold lavish wedding parties as a way of buying into the islands' aristocracy. Mr Fazul, it seems plain, is not a typical Comorian.

Yet the very laxity of the Comoros could make it a place for terrorists to hide and recruit. It would not take much for an explosive-laden skiff to strike one of the oil tankers that pass close to the islands; much of the Middle East's oil exports passes this way. You can buy Comorian citizenship, some say for only $1,000; visa extensions cost much less and visa regulations are often ignored. Security at the airport is as lax as anywhere in Africa. Still, it is unlikely that Mr Fazul can ever come home, even in disguise. But other radicals can move in.

Some Comorians resent the arrival of conservative Pakistanis intent on “teaching the Koran” in the villages. “They're hiding something,” says Soihili Ahmed, editor of *Al-Watan*, a local newspaper. A group of them has set up in a historic mosque in N'tsaoueni, in the north of Grande Comore. The bearded Pakistanis deliver a stern but polite message. Sitting cross-legged on a dusty carpet, brewing tea and eating nuts and sweets brought with them from Karachi, they say the Comorians should “return” to Taliban-style rule. A few of the listeners are Comorian boys. Wild-eyed, speaking alternately with gentleness and religious certitude, could they resemble Mr Fazul at the start of his journey?

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Kosovo's future

A new battlefield

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From The Economist print edition

Reuters

The Russians have staved it off for now, but unilateral independence for Kosovo may still be coming

IN THE Serb-controlled northern part of Mitrovica, in Kosovo, a banner calls on the Russians for help. “In the name of God and justice,” reads another, in English, “do not make our Holy Land a present to Albanians.” Yet a few hundred metres south, across the River Ibar, Albanians stroll around in the sunshine. Kosovo feels calm and peaceful. It could, however, be the calm before the storm.

This week diplomats at the United Nations were working on the fifth draft of a Security Council resolution on the future of Kosovo. Russia has all but promised to veto any text that foresees independence for the territory. It seems that, although the war is far from over, they have won this round in the new battle of Kosovo.

Technically Kosovo is part of Serbia. But since the end of the fighting in 1999 it has been under UN jurisdiction. Some 90% of its 2m people are ethnic Albanians (Kosovars) who want independence. In 2005 the UN invited Martti Ahtisaari, a former Finnish president, to chair talks between Serbia and the Kosovars on the province's future. Serbia says the Kosovars can have anything they want but formal independence. The Kosovars say they will compromise on anything but that.

In March, after the two sides duly failed to agree, Mr Ahtisaari sent the Security Council his own plan for “supervised independence”. This foresaw an independent Kosovo, with highly autonomous zones for the Serb minority and the replacement of the UN mission by an EU mission, with a form of international governor. Serbia rejected this, as did Russia.

The Russians assert that Kosovo's independence against Serbia's wishes would set a precedent for other separatists. Not so, say Western supporters of the plan, who argue that Kosovo is a unique case. Many Western diplomats thought that Russia would eventually make a deal, trading Kosovo's independence for something else. Their mantra has been that “there is no Plan B.” But now, says Veton Surroi, a senior Kosovar politician who is de facto foreign minister, “Plan A is dead.”

Diplomats in New York are trying to tempt the Russians with a resolution which, though not endorsing the Ahtisaari plan, would allow the EU to replace the UN mission in Kosovo. The odds are against them, because the draft calls on Serbs and Kosovars to talk again for 120 days while the EU mission takes over. Once that is done, it would be easier to recognise an independent Kosovo.

Meanwhile, Mr Surroi observes, nobody is saying “what we should talk about.” Diplomats say the talks are

meant to “go the extra mile” but, as Mr Surroi asks, once you have already done a marathon, what is the point of running an extra mile? The answer is that, for now, neither America nor the EU has the stomach to face down Russia. But when the EU mission is running, a unilateral declaration of independence would be easier.

On June 28th Serbs commemorated the 618th anniversary of their defeat in the battle of Kosovo at the hands of the Ottoman Turks. Vojislav Kostunica, Serbia's prime minister, declared that a new battle was being waged for Kosovo. It is a battle of “might or right”, he said, “and only right can win in Kosovo.” Yet Vuk Jeremic, Serbia's foreign minister, seems discomfited by the recent assertion of Russia's Vladimir Putin that the Balkans had always been a sphere of Russian special interest and that it was “natural that a resurgent Russia is returning there.” Russia is a good friend, says Mr Jeremic, but Serbia's strategic priority is still to join the EU.

Serbian and EU officials are at pains to insist that there is no link between Kosovo's future and Serbia's EU aspirations, but in the long run there must be. If Kosovo remains unresolved and restive, the EU will not admit Serbia as a member. Mr Jeremic claims that, in the coalition government, “we are all on the same page”. This is not widely believed. Partisans of President Boris Tadic argue (privately) that joining the EU is more important than keeping Kosovo, whereas supporters of Mr Kostunica say (publicly) that keeping Kosovo is more important than joining Europe.

Privately some Serbs and Kosovars say they could have serious talks on partition, but only, say the Kosovars, if the Serbs are prepared to trade the north of Kosovo for Albanian-inhabited areas of Serbia outside Kosovo. Diplomats hate such talk. For them it risks discussion of similar divisions in Macedonia, Bosnia and beyond.

In the next few weeks Serbs and Kosovars seem likely to be asked to talk again. They will doubtless glare at each other for a few more months, and the issues that confront the diplomats now will then return. At that point, if Russia continues to insist that Kosovo must stay part of Serbia, the Americans and the EU may be forced to do what they balk at now: unilaterally recognise Kosovo's independence.

At least, despite menacing words from some former guerrillas, Kosovars are not reaching for their Kalashnikovs. They understand, says a well-connected source in Pristina, that “any violence would be a bad investment now, because it would give ammunition to Russian diplomats who would argue that we were troublemakers.” For now, says Enver Hoxhaj, a Kosovar deputy, “we are just the first victims of the new Russian imperialism.”

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Bosnia's Muslims

Balkan extremists

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Fears of an outbreak of Muslim extremism in Bosnia are probably exaggerated

ON JULY 9th the trial began at The Hague war-crimes tribunal of Rasim Delic, a former commander of the Bosnian army. He is charged with failing to prevent his troops raping, murdering and even decapitating their Bosnian Serb and Croat prisoners in the early 1990s. Strikingly, many of his troops were foreign mujahideen.

During the war thousands of foreigners came to Bosnia to fight. Many stayed on and took citizenship. An unknown number of Bosniaks (Bosnian Muslims) have been to study in Saudi Arabia and other Muslim countries. All this has raised fears that, under foreign influences, a radical Wahhabism may take root in Bosnia and in the (mainly Muslim) Sandzak region that straddles the border of Serbia and Montenegro (see map in article).

The authorities are worried. Bosnian and Serbian security services are monitoring extremists. In April an alleged Wahhabi leader was killed near the Sandzak town of Novi Pazar. On June 9th Abu Hamza, a Tunisian-born radical Islamist and wartime mujahideen commander, was arrested near Zenica. Bosnian citizenship has been stripped from 400 former foreign fighters.

Bosniaks are uncomfortable about this, but they have no wish for their country to become a terrorist base. At a recent trial in London, it emerged that arrests of men later convicted of plotting attacks in Sarajevo came about thanks to a trail that began on the computer of a Moroccan in London. Yet Anes Alic, director of ISA, a security consultancy in Bosnia, insists that there are “more radical Muslims in London than in Sarajevo.” Few Bosniaks have abandoned their traditions for Wahhabism, though some may have been influenced by Jusuf Barcic, who studied in Saudi Arabia, and was killed in a car crash in May. As many as 3,000 turned out for his funeral; many came from abroad.

Mr Barcic was a close associate of Abu Hamza's. The two made several unsuccessful attempts to seize control of Bosnian mosques. Their failure does not mean that the authorities can let their guard down, says Eldar Sarajlic, a Bosnian academic. He says the struggle for Bosniak hearts and minds is the same as that being waged wherever there are Muslims. Yet the spiritual leader of Bosnia's Muslims, Reis Mustafa Ceric, says he is not worried by extremists, “because my people in mosques and on the streets are clever enough not to follow those who are irresponsible.”

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Turkey's election

In search of the female voter

Jul 12th 2007 | ANKARA AND ISTANBUL
From The Economist print edition

Women will have an important role in Turkey's election on July 22nd

Get article background

IN ISTANBUL'S Carsamba district, women in head-to-toe chadors trail obediently behind bearded men sporting Islamic caps and baggy trousers. Shop windows are crammed with Islamic memorabilia from Mecca. Many secular women fret that, if Recep Tayyip Erdogan's mildly Islamist Justice and Development (AK) Party, which has run Turkey since 2002, wins the election on July 22nd, all of Ataturk's republic may resemble Carsamba.

Turkey's bossy generals and the secular opposition are doing their utmost to encourage such fears. Their tactics sometimes work. Many of those who joined the wave of pro-secular rallies before Mr Erdogan called an early election were urban, middle-class women, who also supported the army's April 27th threat to intervene over the choice of a president whose wife wears the Muslim headscarf.

But if the same ladies thumbed through a study of Turkish women by the Berlin-based European Stability Initiative, their notions about Islam and modernity might change. Entitled “Sex and Power in Turkey”, the paper deconstructs the myth that Ataturk was the sole champion of Turkish women. Certainly, they owe him a huge debt: he made women equal before the law and gave them the right to vote earlier of their counterparts in France and Switzerland, thereby making Turkish women unquestionably freer than any of their sisters in the Muslim world.

Yet the paper notes that such changes “barely penetrated Turkish society beyond a small urban elite”, and patriarchy remained entrenched in both civil and criminal law. Despite growing numbers of women in banking, medicine and academia, Turkey lags behind other European countries on most measures of gender equality. It has the smallest share of women in parliament and the workforce, and the highest rate of female illiteracy. Violence against women is on the rise: the police report a big rise last year, when 842 women were murdered and 1,113 raped.

Awkwardly for secularists, it took the AK government to pass the most radical set of women's reforms since Ataturk. Husbands are no longer officially heads of household, and wives no longer need their consent to work. Laws letting rapists off the hook if they married their victims have gone; new ones make intra-marital rape a criminal offence and scrap reduced sentences for honour killings.

The AK Party's enthusiasm for women's lib may even cost it votes among its more pious constituents. In Carsamba many promise to back the overtly Islamist Saadet party (which is expected to take no more than 2% of the vote). Yet critics still claim that AK's reformist zeal is driven less by conviction than by a wish to please the European Union. As evidence, they cite Mr Erdogan's failed bid to criminalise adultery three years ago.

Hulya Gulbahar, a lawyer who helped to co-ordinate women who were lobbying parliament for reform, says they faced more resistance from the secular Republican People's Party (CHP) than from AK. Tellingly, only 10% of CHP's parliamentary candidates are women. Admittedly, AK does little better. Edibe Sozen, an academic who is among 62 women (out of 550 candidates) fielded by AK, acknowledges that “changing the [patriarchal] mentality is not as easy as changing the laws.”

The judiciary is another problem. Recently, in the case of a woman who was raped by her neighbour, the presiding judge in an appeal court opined that she must have “consented” because she had “not screamed or shouted” during the act. “She kept silent so as not to upset her children,” fumes a lawyer, Fatma Benli. Miss Benli is fighting the ban on the Muslim headscarf in government offices and schools. Shedding her headscarf and overcoat to reveal a lace-trimmed top and a shock of auburn curls, she is indistinguishable in looks and rhetoric from female human-rights campaigners in the West.

Miss Benli, who cannot defend her clients in court because of her garb, argues that, before the headscarf ban in 1998, universities were among the few places where secular and devout Turkish women could mix. “The [headscarf ban] not only polarises society, it runs counter to the very purpose it claims to serve: to modernise Turkish women,” she insists.

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French political scandals

The law above

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Both Jacques Chirac and Dominique de Villepin face legal scrutiny

IS THE judicial trail closing in on France's former president, Jacques Chirac? The question arose this week after the investigation into a smear campaign known as the “Clearstream affair” took a new turn. Mr Chirac's last prime minister, Dominique de Villepin, confirmed that he had been summoned on July 27th to meet two investigating judges who may put him under formal investigation.

The Clearstream affair refers to a fake list of public figures, anonymously leaked to a French judge in 2004, who allegedly held accounts at a Luxembourg-based clearing house linked to kickbacks on the sale of French frigates to Taiwan in 1991. One name on the list was Nicolas Sarkozy, now president, then finance minister and a rival of Mr de Villepin's for the succession to Mr Chirac. The list was ruled bogus, and two judges began investigating the false accusations. Last year Mr Sarkozy became a civil plaintiff in the case.

In the effort to get to the bottom of a complex plot, the judges have put many people under formal investigation. They include Jean-Louis Gergorin and Imad Lahoud, both then executives at the EADS aerospace group. Mr de Villepin has already been heard as a witness. The judges' plan to put Mr de Villepin himself under formal investigation seems to stem from new evidence found on deleted files retrieved from a computer belonging to General Philippe Rondot, a retired spy.

According to leaks in the French press, these contained notes of the general's conversations with Mr Lahoud, who told him that “Jean-Louis Gergorin received instructions from Dominique de Villepin, themselves formulated by the president of the republic, to ‘denounce Nicolas Sarkozy'”. According to General Rondot's testimony, leaked to *Paris-Match*, Mr de Villepin “gave his agreement” for the files to be destroyed. Last week, in Mr de Villepin's absence, the judges raided and searched his Paris flat—an unprecedented move against a former prime minister. The next day, Mr de Villepin was with them during a search of his office in Paris.

Declaring himself “stupefied and indignant” at his trial by the media, Mr de Villepin has stuck to his line that “at no time did I ask anybody to investigate political figures, still less to compromise them”. The allegations against him, he points out, rely heavily on conversations reported by General Rondot, but not witnessed by him. He insists that the real affair is not political but “industrial and financial rivalry”. His lawyers may choose to contest the jurisdiction of the two investigating judges, arguing that, as he was a minister at the time, Mr de Villepin can be tried only in a special court of justice, not as an ordinary citizen.

Where does this leave Mr Chirac? His presidential immunity expired in June and the two Clearstream judges have requested a hearing with him as a witness. But Jean Veil, Mr Chirac's lawyer, told Europe 1 radio that he had refused, arguing that the constitution states that “The president of the republic shall incur no liability by reason of acts carried out in this official capacity.” In other words, Mr Chirac will co-operate with judicial investigations into periods before he became president in 1995, but not after. This decision, Mr Veil said, was “absolutely definitive”.

Even if Mr Chirac avoids testifying in the Clearstream investigation, other cases are outstanding from his time as mayor of Paris in 1977-95. One, led by Alain Philibeaux, a judge in Nanterre, concerns a fake jobs scheme for officials of Mr Chirac's party. This was the case in which Alain Juppé, Mr Chirac's right-hand man at the town hall, was convicted of political corruption in 2004. Mr Veil has confirmed that Mr Chirac will appear as a material witness before September 15th. He may have to testify in another case, led by Xavière Simeoni, a judge in Paris, also concerning fake jobs at the Paris town hall.

Mr Chirac may yet be held to account in these pre-1995 cases. This would fit Mr Sarkozy's desire to end France's culture of impunity. He has said that this year he will put an end to the tradition of a mass presidential pardon on July 14th, Bastille Day, although he will still consider cases on individual merit. If

Mr Chirac's lawyers are right, though, the former president could emerge unscathed from the Clearstream affair. So if Mr de Villepin were put under formal investigation, it would be one more example of one of Mr Chirac's loyal lieutenants being called to account while the boss goes untouched.

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Poland's unsteady government

Crash, bang, fizzle

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From The Economist print edition

The ruling coalition wobbles, but survives for now

Get article background

OUTSIDERS often mock Poland's prickly, obstinate prime minister, Jaroslaw Kaczynski. But a collapse of his government, followed by months of instability, might be worse. An anti-corruption watchdog this week named a deputy prime minister, the temperamental farmers' leader Andrzej Lepper, in a bribery scandal. Mr Kaczynski promptly sacked him (for the second time).

Mr Lepper, who denies any wrongdoing, threatened to take his party, Self-Defence, out of the coalition. That would have meant minority rule and perhaps an early election, bogging down Poland's haphazard reforms completely. The European Union's most unpredictable member would be even harder to handle. But Self-Defence does not want an election campaign in which its already pungent reputation for cronyism might take centre stage. Fearing a revolt, Mr Lepper apparently backed down, suggesting his party may stay in the coalition “conditionally”.

Mr Kaczynski's Law and Justice Party may also want to defuse a row with its hardline Catholic supporters before facing voters. Father Tadeusz Rydzyk, who runs a highly politicised media empire, recently called Mr Kaczynski's sister-in-law a “witch” who deserved “euthanasia” because of her support for abortion. That prompted a rebuke from her husband, Lech Kaczynski, Jaroslaw's twin brother and Poland's president.

Law and Justice's embrace has proved near-fatal to the other coalition party, the nationalist League of Polish Families. It may now do the same for Self-Defence. Mr Kaczynski can thus safely go for an early election whenever he chooses. But his canny politicking is not matched by ability to govern. Attempts at health reform, for example, have brought doctors at more than 200 hospitals out on strike. Nurses demanding higher wages are camping in tents outside Mr Kaczynski's office. They say he has broken election pledges to help losers from the post-1989 transition, such as ill-paid public-sector workers.

The government has also failed to reform public finances, essential if Poland is to follow Cyprus and Malta into the euro (see article). Its main boasts are reforms in the intelligence services, stronger anti-corruption efforts and weeding out communist-era secret-police collaborators. These may have been worthwhile, but the government's approach has been highly partisan, even vengeful. Public administration is lamentably backward.

As the political system fails to reflect Poles' exasperation with their poor quality of life, many are voting with their feet. Some 2m have gone abroad since Poland joined the EU, and a recent survey found another 3m planning to do the same. This is aggravating labour shortages that may undermine the country's competitiveness.

Poland's foreign policy is also being mismanaged. At the recent EU summit, Mr Kaczynski won a delay on new voting rules that will reduce Poland's weight. But the victory was marred by his graceless approach, using Poland's wartime suffering at German hands as a bargaining chip. It was Germany that pushed hardest for Poland's EU entry. Now German diplomats in Warsaw say relations cannot improve so long as the Kaczynskis are in power.

On the foreign front, things may get worse still. Law and Justice has just suspended its most sensible foreign-affairs expert, Pawel Zalewski. A deputy leader of the party, he dared to quiz the lightweight foreign minister, Anna Fotyga, at a parliamentary hearing. The disconnection between Poland and its EU partners was underlined when a Polish candidate to run the IMF was brushed aside. Both Poland and the EU would like to see a strong, dependable government in Warsaw. It may be some time before they get one.

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Malta, Cyprus and the euro

Into the club

Jul 12th 2007 | VALLETTA
From The Economist print edition

The euro prepares to take in Malta and Cyprus

Get article background

“EVER since the 11th century, when the Arabs were ejected, Malta has looked to the north,” says its central-bank governor, Michael Bonello. On July 10th the European Union's smallest member took its biggest step north since its entry three years ago. It received approval from EU finance ministers to join the euro next January, along with Cyprus, taking membership up to 15.

“For a trading nation like ours, it is one headache less,” says Mr Bonello. Malta does three-quarters of its trade with the EU. Membership of the euro eliminates the cost of swapping into and out of a currency used nowhere but a small Mediterranean island. It will help tourists from the euro area and the growing number of overseas firms drawn by Malta's sunny climate and well-educated, English-speaking workforce.

An even better reason for joining the euro is what Malta had to do to qualify. It is a textbook case of the beneficial effects of meeting the entry criteria. Three years ago, Malta's public debt was almost 75% of GDP and its budget deficit nearly 5%. To qualify for membership, Lawrence Gonzi's centre-right government imposed austerity measures that would have been unthinkable without the lure of euro entry.

British colonial rule, which ended in 1964, left the islanders with a large public sector, a generous welfare state and a pervasive jobs-for-life, state-will-provide outlook. Yet in recent years the workforce at the Valletta docks, once the hub of Malta's economy, has been cut by 3,000. The island's loss-making national shipping line has been closed, and its telecoms firm and airport privatised. The government has frozen public employment and wrung from the unions a six-year deal on public-sector wages.

As the opposition Malta Labour Party (MLP) stresses, the government has also had to raise taxes. Alfred Sant, the MLP leader, has been iffy about joining the euro, as he was about the EU, and complains that “they promised the moon and stars. But it has been a hard slog.” The ruling Nationalists are five points behind in the polls, and have lost every local election for four years. Yet Mr Gonzi is optimistic that his reforms will bear fruit before he faces re-election: “We are reaping the benefits and I believe people are seeing that.” GDP growth in the first quarter was a perky 3.5% (at an annual rate). The government cut the tax burden in its 2007 budget. Unemployment is the lowest in 12 years.

Still, it is with a rueful smile that Mr Gonzi quotes his Luxembourg counterpart, Jean-Claude Juncker: “Every finance minister knows what to do. But then no one knows how to win the next election.” Malta's is due next year.

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Charlemagne

The lessons of history

Jul 12th 2007
From The Economist print edition

Peter Schrank

Nicolas Sarkozy revives some old arguments about the governance of the euro

Get article background

IF YOU want to understand why Nicolas Sarkozy makes some of the leading lights in the European Union feel uneasy about the future, you must look at the past. So much about the French president is exciting and unfamiliar, in Brussels as elsewhere. It therefore seems odd to find that the big concern of some veterans is that Mr Sarkozy will drag Europe back into old quarrels they thought they had settled long ago.

Nowhere is this clearer than in Mr Sarkozy's calls for a “European economic government”. This remains a mushy concept, for all Mr Sarkozy's manic energy (in this week's theatrical coup, he invited himself to a Brussels meeting of euro-area finance ministers to persuade them to accept his plan to stretch the stability pact's timetable for eliminating France's budget deficit). As far as the Eurocrats can make out, economic government means giving elected national politicians the last word over broad swathes of EU economic policy, including the exchange rate and budget discipline, while not actually scrapping such totems as the independence of the European Central Bank (ECB).

If such a thing came about, it would certainly be new. It would also be of a piece with Mr Sarkozy's belief in the primacy of political will, his vows to save Europe from rule by technocrats and his desire that the EU should “protect” people from a brutal, globalised world. But Brussels has a long memory and knows that calls for economic government in Europe are not really new at all. Indeed, they have been a refrain of French political leaders, of right and left, for two decades.

A French history of the single currency* credits François Mitterrand with the first public call for “an economic government for Europe”, in an October 1990 speech to a Franco-German summit in Paris. In a rhetorical flourish that Mr Sarkozy might envy, Mr Mitterrand called Europe's planned single currency and central bank mere instruments that lacked a soul. When Mr Sarkozy, in a speech in Strasbourg, denounced Europe for “substituting technical expertise for political will”, old-timers could hear echoes of a battle-cry by Pierre Bérégovoy, finance minister in 1989: “no to rule by technocrats, yes to rule by democrats”. When Mr Sarkozy asks why the European single currency is not placed “at the service of growth and jobs”, and attacks the “overvaluation” of the euro, he is repeating almost verbatim two of the four conditions set by French Socialists for accepting the euro just before Lionel Jospin's surprise 1997 election victory.

This sense of déjà vu may cause EU leaders some nasty headaches. One concerns trust. During the years of wrangling over the formation of the euro, German negotiators suspected their French counterparts of usually paying only lip service to central-bank independence and budget discipline. Each time they heard calls for more political oversight, they suspected their French partners of secretly dreaming of bad old habits, from budget-busting torrents of public spending to protectionism to devaluation to boost exports.

If forced to bet, most senior EU officials now believe that Mr Sarkozy is serious about structural reforms in France. They accept the line that a French leader intent on such reforms must carry his voters with him—and that a majority of them are not ready for purist liberal orthodoxy in the style of Brussels or Frankfurt. But to some extent, the EU is being asked to undertake an exercise in clairvoyancy, giving Mr Sarkozy his political capital now before knowing if he will see his reforms through.

Nor do Brussels officials relish hearing Mr Sarkozy saying things they believe to be wrong, eg, about a strong euro choking exports. Commission officials have been handing out statistics showing how France's trade surplus with America has grown despite the weak dollar, whereas French exports to Germany have fallen even though they share a currency. That is before anyone mentions the German export boom that led Peer Steinbrück, Germany's finance minister, to declare teasingly, “I love the strong euro” as he arrived to hear Mr Sarkozy this week.

From Brussels with disdain

A second headache is the reopening of old debates about how sovereign states should align their economies and merge currencies, but at the same time remain democratically accountable to voters. Mr Sarkozy endured a rather bruising visit to Brussels. Partly this was sheer grumpiness that France is yet again using its big-power status to bend the stability-pact rules. Wouter Bos, the Dutch finance minister, pointedly told Mr Sarkozy that Europe should not be like “Animal Farm”, in which “some are more equal than others”. The truth is that big countries do not have to obey the same rules, and Mr Sarkozy will probably get away with missing the original 2010 target for eliminating his budget deficit. This is not so shocking: the pact was reformed to allow flexibility to countries undertaking structural reforms.

But Mr Sarkozy will face more resistance if he seriously pushes for greater political oversight of economic policy, starting with the ECB's mandate to concentrate on price stability. In the words of one senior Eurocrat: “This has very deep historical roots. Putting exchange rates at the service of growth comes very naturally to the French—they did it repeatedly in the past 50 years—but it sends a shudder down German spines, because it makes them think of runaway inflation.” In German memories, inflation helped to pave the way for Nazism, meaning that price instability can be a threat to democracy itself.

Does Mr Sarkozy really intend challenging this piece of EU orthodoxy which lies at the heart of the grand bargain that led to Europe's economic and monetary union? The answer to that question, as to so many others about his intentions, lies in the future. If he tries it, though, his chances of success are surely slim. And the explanation for that lies firmly in Europe's past.

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* “Ces Hommes Qui Ont Fait l'Euro”. By Jean Quatremer and Thomas Klau. Plon, 1999

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Correction: Ukraine

Jul 12th 2007
From The Economist print edition

In the final paragraph of our story on Ukraine last week, the parties got jumbled up. Our Ukraine is Viktor Yushchenko's, the Party of the Regions is Viktor Yanukovich's.

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North Sea oil

When the wells dry up

Jul 12th 2007 | ABERDEEN
From The Economist print edition

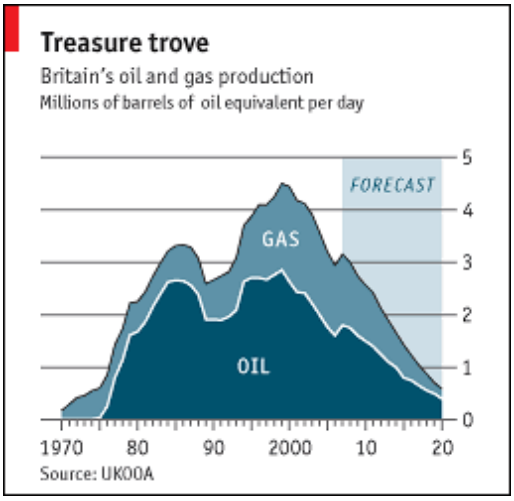
Alamy

Offshore production has spawned a high-tech cluster of British businesses with global ambitions

“EVERYONE else in Britain hangs on what the Bank of England does with interest rates,” says one proud Aberdonian. “Up here, we don't care about that. We're much more interested in what OPEC does to the oil price.” An exaggeration maybe, but Aberdeen is the Houston of an offshore industry that has long made Britain a big oil and gas producer.

The petropounds coursing through the “Granite City” on the north-east coast of Scotland have turned Aberdeen into one of the most prosperous cities in Britain. The typical worker makes £481 ($971) a week, compared with median earnings of £447 across Britain. The city's unemployment rate is well under the national average. The oil industry employs 33,000 people directly in Aberdeen and is estimated to provide work for 400,000 in Britain.

Aberdeen is booming now thanks to high oil prices, but the future looks less rosy. Offshore output peaked eight years ago, when Britain was the world's sixth-biggest producer of oil and gas; by 2006 it had become the 12th-biggest. The International Energy Agency said on July 10th that the drop in production had been steeper than expected. “There'll be nothing here in 15 years' time,” says one former offshore worker. “Oil's been good to me, but I wouldn't want my son going into the business.” The recent decision by Royal Dutch Shell to sell off several of its North Sea fields and to abandon the construction of a £25m headquarters in the city has added to local worries.



Yet even though oil and gas output is declining, the local businesses that have sprung up to support it have bright prospects. The North Sea was one of the earliest offshore oil basins to be developed. Many of the technologies needed to produce oil from underwater wells—especially in the difficult, gale-prone waters off the British coast—were developed in Scotland. Around 90% of oil-industry workers are employed not by the big international companies such as BP or Total that operate the fields but by local businesses.

For example, Wood Group is a big oil-services firm that specialises in, among other things, enhanced-recovery technology and offshore pipelines. Sub-Atlantic is a small outfit that makes remotely operated

submarines. Altogether such businesses—covering everything from catering and construction to geology and engineering—have a turnover of around £11.7 billion a year. The hope is that they will be able to sell the expertise they have acquired in the North Sea to an industry searching for oil and seeking to maximise production in ever more testing submarine conditions around the world.

One area of particular British expertise is in subsea technology, a catch-all term for things such as automated wellheads and long pipeline networks on the seabed. These allow oil companies to use cheap ships instead of expensive fixed platforms and enable them to operate several wells from one platform many miles away. Remotely operated vehicles are used to install and maintain equipment where water is too deep for divers.

In 2005 Britain's subsea industry's output was worth around £3.4 billion, half of which was exported, a 20% rise on the year before. There are big opportunities to keep growing fast. British firms account for half of global sales, and the industry is expanding rapidly. The world market for subsea services could be worth $40 billion by 2011, according to Scottish Enterprise, a development agency. David Pridden, the boss of Subsea UK, a trade agency, thinks exports from the British industry could reach $15 billion by 2020.

Local businesses also have experience in squeezing more output out of existing fields, or cheaply developing smaller ones—something that should extend the life of Britain's North Sea industry (see article). As big finds become rarer, producers are focusing on how to extract oil from smaller reservoirs that can be geologically or technically tricky to operate. “As other oilfields around the world begin to mature, there'll be a centre of expertise here that can tell them how to get the most out of their remaining reserves,” says Geoff Runcie, the boss of the Aberdeen and Grampian Chamber of Commerce.

The city's cluster of high-tech businesses may have sprung up to support the North Sea oil industry but there are also opportunities beyond it. Many local firms have branched off into other areas, such as defence. Technologies developed to pull oil and gas from the ocean floor can find other uses, too. When a Russian mini-submarine became caught on the Pacific seabed in 2005, it was cut free by a British remotely operated submarine based on technology developed for the North Sea.

Aberdeen also has ambitions to exploit its oil-support know-how in green energy. The hope is that local businesses with expertise in offshore construction and engineering can provide services to firms building offshore wind turbines or, in future, tidal and wave-powered generators. And even exhausted oil and gas fields may come in handy. One idea is that they can be used to store carbon emissions from fossil-fuel power plants.

The city is not short of ambition, but cooler-headed businessmen point out that it is easier to recognise opportunities than to grasp them. Exports still account for only about a quarter of the oil-support industry's output. Last year they grew by just 2%, compared with 16% in 2005, despite efforts by Scottish Enterprise to encourage firms to expand overseas. Oilmen make similar complaints to their counterparts in the rest of Britain's engineering sector: that the country lacks skilled workers; the standard of technical education is inadequate; and the government is ineffective in tackling these problems.

Yet such complaints have been made ever since the first North Sea well started pumping in 1967. The cluster of businesses in Aberdeen has achieved a critical mass thanks to the North Sea. It now stands a good chance of thriving in more distant offshore markets as the demand for energy continues to boom.

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Oil and gas production

Every last drop

Jul 12th 2007
From The Economist print edition

How to prolong the North Sea's life

THERE is no shortage of oil and gas beneath the North Sea. Total production so far has been around 34 billion barrels, and roughly 20 billion are thought to remain. Indeed, production is forecast to rise slightly this year, to 3.1m barrels a day from 2.9m in 2006, thanks largely to the discovery of the Buzzard field, which came on stream in January.

But big finds are the exception and the rise in output will be only a small blip in a downward trend. Buzzard, which contains 500m barrels, was the largest discovery for ten years. Much of the remaining oil and gas in the North Sea is stored in small or geologically tricky deposits that are expensive and difficult to develop profitably.

Technology is one way to keep the hydrocarbons flowing. BP's Rhum field, for example—with temperatures of 150°C and pressures up to 12,700 pounds per square inch—has been known about for years, but drilling technology has only recently advanced to the point where production is practical. Improved seismic surveys can give a better idea of what is present below the seabed. High-tech imaging persuaded Total, a French firm, to develop the Jura field (another large find of 170m barrels), which is due to start production in 2008.

Another option is to bring in specialist firms. Big oil companies are often uninterested in small fields, preferring to pursue larger and more profitable developments elsewhere. In 2003 the government created new, cheaper licences to try to attract firms that specialise in wringing as much as possible from small or partially depleted fields. Half of the 150 licences granted last year fell into this category.

The industry is also eyeing the few unexplored frontiers in the North Sea. The seas west of the Shetland Islands are thought to hold billions of barrels of hydrocarbons, mostly natural gas. But the lack of infrastructure in such a remote area would make it difficult to bring production to shore. And although oil prices are high, gas prices have slumped following the opening earlier in the year of a big import pipeline from Norway.

Despite these difficulties the government wants Britain still to be pumping 3m barrels of oil and gas a day by 2010. But its actions belie its words. As chancellor of the exchequer, Gordon Brown raised taxes on the industry in recent years. Oil firms now pay a 50% corporation tax on new developments, compared with the 30% rate charged on other companies. The tax squeeze on the North Sea oil industry may end up accelerating its decline.

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Feudal Sark

Democratic revolution

Jul 12th 2007 | SARK
From The Economist print edition

Sark may pay a price for losing its feudal exceptionalism

TRACTOR-DRAWN fire engines, £1 notes and an annual sheep race are some of the quaint attractions of the dinky British dependency of Sark, a Channel Island. Even stranger is its feudal constitution, scarcely altered since the island was colonised in 1565. In charge is the *seigneur*, who leases the entire island from the crown for £1.79 ($3.62) per year and sub-lets it to the 600 islanders. The bigger landholders get 40 seats in Chief Pleas, the parliament that meets in an old schoolhouse under a portrait of the queen. Just 12 seats are taken by elected commoners.

But on July 4th Sark decided to end the feudal era. Chief Pleas agreed to limit landowners to 12 seats and beefed up the commoners' share to 16. The first election under the new system will be held next year and a referendum by 2012 could remove landowners' seats entirely.

Two campaigners for reform are Sir David and Sir Frederick Barclay, twin tycoons who live part-time on Brecqhou, a nearby tiny island over which Sark claims overlordship. The Barclays, who bought Brecqhou in 1993 and have built a neogothic castle there, have repeatedly used the European Convention on Human Rights to challenge Sark's feudal ways.

Other ancient practices are ripe for change. Local land laws make it impossible to get a mortgage, forcing buyers to use pricey personal loans instead. They also prevent entrepreneurs from taking out loans secured against their homes. Such restrictions have made for a sluggish economy and a thin middle class. In a poll last year, 56% of islanders said they wanted full democracy.

Yet upholding human rights is an expensive business. The island's two volunteer constables now need a paid assistant to keep track of charge sheets and to ensure that overnight guests in the island's cells are properly monitored. Taxes were once set by a committee that guessed what each person owed. “Tax law used to take up half a page; now it's a book,” laments Michael Beaumont, the *seigneur*. He remembers when the meetings of Chief Pleas wound up in time for lunch. Now each of its sessions lasts two days. It, too, has begun employing an administrator.

The shock of the new is placing a heavy burden on an island that cannot afford a full civil service. It may one day have to throw itself upon Guernsey, its much larger neighbour—and in so doing, lose its right to set taxes, which are currently rock bottom. Sark's democratic revolution sounds good in principle but it may cost the island its independence.

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Two by-elections

A litmus test

Jul 12th 2007 | SOUTHALL
From The Economist print edition

A pair of contests will provide a verdict on the parties' new plans

Gordon Brown

THE Himalaya Palace cinema in Southall, west London, is plastered with posters for Bollywood movies. The dashing young Asian man grinning from the largest banner on its wall could pass for an actor himself at first sight. But Tony Lit, a 34-year-old local businessman, is the Conservative candidate in the Ealing Southall by-election, due to take place on July 19th. The contest, triggered by the death of the previous MP in June, will be on the same day as a by-election in Sedgefield, Tony Blair's former constituency, which also needs a replacement as Mr Blair heads off as a super-envoy to the Middle East. As the first elections since Gordon Brown became prime minister, these will be early gauges of his performance.

Barring a political earthquake, Labour has Sedgefield sewn up. Mr Blair's majority in 2005 was 18,457, and no other party has come close to winning the seat for decades. Ealing Southall, on the other hand, might be up for grabs—at least judging by the cabinet ministers hurriedly dispatched to campaign there. On July 11th Hazel Blears, the communities secretary, was beetling around shaking hands with all who dared cross her path. The previous day David Miliband, the foreign secretary, did his bit. Labour Party organisers are expecting a minister a day until polls open.

Labour's worry about this seat, which has an 11,440 majority, is partly down to Mr Lit, who as director of his father's Asian radio station, Sunrise, is well-known to the constituency's Asians, who make up half its population. The Tories have struggled to break through in Southall, where supermarkets sell every spice under the sun and the local pub accepts rupees. Now the number of blue posters along its main thoroughfare suggest they may have cracked it—though opponents claim these supporters are just business mates of Mr Lit's father. Labour has been further rattled by the defection of a gang of its councillors to the Tories, following epic in-fighting.

As these local battles are fought, the national political scene is coming into sharper focus. On July 10th the Conservatives' “social justice” policy group, led by Iain Duncan Smith, a former party leader, offered its solutions to everything it thinks is wrong with Britain after a decade under Labour. Much of the lengthy report could have come straight from the pen of a social democrat, such as an expansion of credit unions to tackle personal debt and swingeing extra taxes on alcohol. What clear blue water there was came from a plan to shore up marriage through a tax break costing £3.2 billion a year.

Two days later, the Liberal Democrats published their wish-list, with the emphasis on green issues. They would cut the basic income-tax rate by 4p, said Vince Cable, the party's shadow chancellor, to be paid for by raising environmental taxes and cutting relief on capital gains and pensions.

For a government that has been in power for over a decade, crafting eyecatching proposals to rival these is tricky. So Labour is sticking to the message of “lots done; lots to do”. More spending on schools and a national consultation on improving the lot of children, said Ed Balls, the schools minister; lots more cheap houses, pledged Mr Brown. The prime minister has also indicated that he is likely to drop the unpopular plan to allow a super-casino in Britain.

Despite all this, the hot topics in Ealing Southall are fairly traditional election fodder. The main candidates are big on crime and anti-social behaviour, along with transport, which swung last year's local elections in the area in the Tories' favour.

If the Conservatives do well next week, it would be a vindication of David Cameron's policy of picking more diverse candidates. Two years ago Tory election posters read: “It's not racist to impose limits on immigration. Are you thinking what we're thinking?”. This week, as he booted a football back into a school playground and chatted with shopholders, Mr Lit made that seem like another age. Mr Cameron has made the party more approachable, he says. “Whatever the result, it is going to be positive for the Conservative

Party.”

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Financial education

Poor young things

Jul 12th 2007
From The Economist print edition

Teenagers need to do better at maths to avoid a bleak financial future

WHEN today's youngsters leave school they can expect a lot less hand-holding about money than their elders used to get. Few employers still bear the investment risk for pensions, since most final-salary schemes have been closed to new entrants. Easy credit is on tap and mortgage lenders are offering loans worth five times annual earnings.

So it is worrying that the evidence suggests that young people are less canny about money than older ones, who in their turn are hardly financial whizzes. In 2006 the Financial Services Authority, the industry regulator, surveyed the nation to discover how well people managed their finances and how much they knew about money matters. It discovered that almost half the population had no savings at all, including plenty of people on above-average incomes.

One person in five couldn't tell what inflation of 5% and an interest rate of 3% would do to the buying power of their savings. One in ten couldn't work out whether a discount of £30 on a television originally priced at £250 was better or worse than a 10% discount.

Younger respondents turned out to be worse at budgeting and basic arithmetic than older ones. True to stereotypes, they were particularly over-represented among the four in ten who agreed that they tended to live for today and let tomorrow take care of itself.

The increasing uncertainties young people face, together with the evidence that they are ill-equipped to deal with them, have led to a growing consensus that better financial education is needed. On July 12th an answer of sorts came in a syllabus for a new secondary-school subject. “Economic well-being and financial capability” is to be taught from 2008. Topics include personal finances, dealing with risk and becoming a critical consumer of goods and services. And from 2010, to get a GCSE in mathematics, 16-year-olds will have to study “functional mathematics”, likely to include sums involving budgets, interest rates and inflation.

Simply lecturing teenagers about the importance of saving for a pension is unlikely to help, though; they will probably dismiss such matters as irrelevant to immortal beings such as themselves. And personal finances and pensions are often perceived as boring, says Rachel Thomas, who edits *Plus*, a magazine about maths and its applications. “Our readers are keener on computer-generated imagery in the movies, black holes and the maths of climate change.”

In any case, financial products change so fast that any specific information is likely to become outdated. Had today's 25-year-olds been taught about final-salary pension schemes in school, the information would have had little effect other than to highlight what a raw deal they can expect in comparison with their elders.

There is also the problem that financial education is of little use unless children have grasped some elementary mathematical concepts. Here, schools have plenty of room to improve. One child in four leaves primary school without having reached the expected standard in maths and British teenagers do poorly on international comparisons.

So perhaps the forthcoming review of primary maths teaching announced by Ed Balls, the new schools minister, on July 10th is good news. Or perhaps not. His Tory opposite number, Michael Gove, pronounces himself deeply unconvinced that yet another in a long line of reviews will improve matters. “We've had the intensive numeracy strategy in 1998, then Maths Year 2000, then Gordon Brown's response to the Roberts review on maths teaching in 2002, and in 2005 a new strategy that prioritised the small-group teaching of maths,” he points out.

No doubt Mr Balls is hoping for a rabbit to be pulled out of a hat, as happened with a similar review in

2006 of the way reading is taught in primary schools. That recommended a return to traditional teaching methods and the increased use of “synthetic phonics”—sounding out letters and syllables—in place of the methods that became popular in the 1960s, when children were taught to recognise whole words and resort to guessing when they got stuck. He is likely to be disappointed. Mathematics education never succumbed to such fads—perhaps because few of the trendiest educationalists were much good at the subject.

The real barrier may be teachers' lack of numeracy. On July 10th a report by Politeia, a think-tank, said that a third of primary teachers do not have two A-levels, and that among those who did, few had studied maths or science past GCSE.

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Red tape

Blunt scissors

Jul 12th 2007
From The Economist print edition

Attempts to curb regulations are not working

IT WOULD be hard to find a more absurd exercise than the government's draft 98-page assessment of the merits of changing the regulations about ear tags for sheep and goats. The current rules say that all sheep must have a government-approved plastic tag (of any colour but red) applied in one ear, preferably the left. Now the government, implementing a European ruling, proposes to insist on an electronic tag as well, and to tell farmers not only on which ear it should be stuck (the left, again) but also exactly where (don't ask).

Such detailed and prescriptive rules may warm the bureaucratic heart, but are becoming ever more costly. The British Chambers of Commerce (BCC) recently reckoned that the cumulative burden to business of regulations passed since 1998 was more than £55 billion. A government-appointed task force put the annual cost of all red tape to the economy as a whole at a startlingly high £100 billion. Rules can also have a more insidious effect. This week Richard Lambert, the head of the Confederation of British Industry (CBI), called for a “consistent attack on the red tape and regulations that only serve to dampen entrepreneurial flair”.

Although complaints about red tape sound familiar, promises to do something have gained new urgency of late. Gordon Brown, anxious to present himself as business-friendly, has swiftly shown his good intentions by creating a department for business, enterprise and regulatory reform. The new department, which absorbs most of the work that went on at the former trade-and-industry ministry, is in charge of the Better Regulation Executive, an outfit charged with cutting red tape and damming the flow of new rules.

The main weapon against unnecessary red tape is the regulatory impact assessment. This is meant to quantify the costs and benefits of new regulations as well as the balance of advantage of doing nothing. The government now produces about 300 of these assessments a year. Equipped with them, ministers should be able to make sounder decisions on whether new rules are needed and, if so, how they can be framed to cost as little as possible. Similarly armed, opposition politicians and the public should also be in a better position to hold the government to account.

Worryingly, though, a report out this week from the National Audit Office (NAO) shows that these lofty aims are seldom achieved. The government watchdog found that only five out of 19 regulatory assessments provided “good quality” analysis of the costs and benefits of proposed rules, while four did a downright bad job with “major defects” in their analysis. Only one of the 19 recommended that the government do nothing. This suggests that they are not really being used to formulate policy, but are instead seen as a hurdle to be cleared once a course of action has already been decided.

Nor are they being used to hold ministers to account. The NAO found that the clerks working for parliamentary committees did not trust the information in them and rarely used them to inform the work of committees. “It reinforces notions that impact assessments are a token exercise,” says Matthew Fell of the CBI. “Decisions are being taken without an understanding of the costs and consequences.”

Fretting about the adequacy of the government's assessments may mean that a bigger problem is being overlooked. The BCC reckons that almost three-quarters of the regulatory burden on business now comes from European directives. Britain has little leeway in deciding whether to introduce these rules, which, for instance, include those on electronically tagging sheep. But it has often proved too fervent when implementing European rules, making them more prescriptive and onerous than even those passed in Brussels.

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Law firms

City magic

Jul 12th 2007
From The Economist print edition

London's "magic circle" starts to catch up with New York's "white shoes"

Capital law

Financial year 2006-07

Company	Location	Turnover, $m	% increase on a year earlier	Profit margin, % of turnover*
Clifford Chance	London	2,269	22	31
Linklaters	London	2,126	26	44
Freshfields Bruckhaus Deringer	London	1,910	20	49
Skadden, Arps, Slate, Meagher & Flom	New York	1,850	15	51
DLA Piper	International	1,804	17	26
Allen & Overy	London	1,678	27	39

Source: *Legal Business* *Before equity partners' remuneration

BOOSTED by booming international financial markets, the City of London has not had it so good since the end of the dotcom bonanza in the late 1990s. Basking in double-digit growth rates, London's law firms have both contributed to that success and benefited from it. The earnings of top City lawyers can now exceed £2m a year.

Having opted to expand and go global ahead of most others, Britain's leading law firms tend to be bigger than their American rivals. Indeed, according to a survey of the world's top 50 law firms, compiled by *Legal Business*, a British trade paper, five of the world's top six law firms—in terms of turnover—are now British (if DLA Piper, the result of an Anglo-American merger, is included). But they have tended to lag behind in terms of their profitability. That is now changing.

The profit margins of the City's five "magic circle" firms—Clifford Chance, Slaughter and May, Allen & Overy, Linklaters and Freshfields—have soared in recent years and are now comparable with, if not higher than, those of New York's "white shoe" elite. Slaughter and May, the only one of the five not to have gone global, has the joint second-highest profit margin among the top 50.

Not so long ago, a London surgeon could expect to earn as much as a City lawyer. But even the recent big rises in hospital consultants' earnings pall in comparison with those enjoyed by London lawyers. At Slaughter and May, for example, average profits per equity partner (PEP) jumped by almost a third (in dollar terms) last year to $2.75m—more than at any other of the top 50 law firms bar two in New York where PEP averaged $2.8m and $3.0m respectively. Some senior partners get a lot more of course.

Competition for the best lawyers is fierce and poaching frequent. Hence the need to keep headline PEP figures up—even at the cost of getting rid of equity partners, leaving a bigger share of the bounty for the remaining ones. Freshfields is in the process of shedding around 100 of its equity partners. Other leading firms are also undertaking painful restructuring.

Newly qualified lawyers' salaries have also been shooting up in the search for the best talent. Both Freshfields and Allen & Overy now pay their first-year associates £65,000, rising to around £90,000 after three years. (First-year associates at America's top law firms get the equivalent of £80,000.)

But, as many other top-rank City employers have discovered, big earnings do not necessarily guarantee big satisfaction. According to a YouGov poll, published by the *Lawyer* earlier this month, a quarter of Britain's lawyers (including a fifth of law-firm partners) would like to leave the profession. The disgruntled complained about cripplingly long hours, intense competition and the impersonality of the biggest firms (some with more than 3,000 lawyers). So why don't they quit? Because, say three-quarters, of the pay.

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Bagehot

Pity, fear and the F-word

Jul 12th 2007
From The Economist print edition

Steve OBrien

Alastair Campbell's diaries, released this week, are more revealing than the prince of spin probably intended

Get article background

ALASTAIR CAMPBELL has a thing about underwear. When he worked as a tabloid journalist, he propagated the famous legend that John Major, then Tory prime minister, tucked his shirt into his pants; and “The Blair Years”, the diary of his time as media hatchet-man to Mr Major's successor, is full of them. In Tokyo, Tony Blair sits in his knickers with a helmet on his head, pretending to speak Japanese. In his yellow and green pair, Mr Blair looks like Austin Powers. There is precious little sex (though Mr Blair appears in the buff and another minister in the bath). Nor is the book as politically sensational as it would have been, had Mr Campbell not censored it. But it is still revealing, intentionally and otherwise.

By his own account, he has omitted much of the stuff that might have damaged Gordon Brown. Mr Blair, his ex-spokesman records, considered Mr Brown one of three indispensable talents, with Peter Mandelson and Mr Campbell himself. But we do see most of the top, rivalrous figures in the Labour Party locked in a war of all against all, with Mr Blair trying to reconcile them like a frazzled parent. There is Mr Campbell versus Cherie Blair; Mr Campbell versus Mr Mandelson (including a punch-up that Mr Blair breaks up); and Mr Brown, like John Prescott, the deputy prime minister, against more or less everyone.

As well as the clashing egos, the diary depicts the sheer frenetic workaholism of politics, the drama and tears of ministerial dismissals, Mr Blair's obsessive fears of electoral defeat, and how it warped his policies. The person who probably emerges worst from this mêlée is Clare Short, an ex-minister (“fucking mad”, says Mr Prescott). The royal family is archaically otherworldly. Mr Blair has his faults: he is a selfish boss—there is a funny bet between Mr Campbell and Mr Mandelson about how long it will take him to offer them a cup of tea—with an embarrassing penchant for flashy holidays and appalling dress sense. But in general Mr Campbell is loyal to the point of infatuation.

Another of his heroes is Bill Clinton. The book's highest value to historians may be as a record of diplomacy, particularly over Kosovo and Northern Ireland (at one point Mr Clinton “said he'd rather be on holiday with Kenneth Starr” than hanging out with the Ulster politicians). Vladimir Putin reminds our diarist, not very flatteringly, of his own perpetually cross wife. George Bush jokes about being a “crazed unilateralist”, telling Mr Campbell that if he “wins the vote in Parliament [over Iraq], I'll kiss your ass”, and comparing drinking regimens from the days when they were both alcoholics. In 2002 Mr Bush

reputedly thought Osama bin Laden was dead, but was reluctant to say so. When they first met, Mr Bush and Mr Blair talked about God.

These are the sort of vignettes that casual readers will enjoy most. We see Mr Blair, Mr Clinton, Romano Prodi, Helmut Kohl and Wim Kok all peeing together at a NATO summit; Fidel Castro praising Mr Blair's "Third Way"; an African president pinching Mrs Blair's bottom; the Blair children teaching Gerry Adams and Martin McGuinness to skateboard; Mr Brown locked in a toilet, during a row over whether he or Mr Blair should be Labour leader; Mr Campbell, Mr Clinton and Kevin Spacey visiting a McDonald's in Blackpool; Mr Blair borrowing a suit from a man on a runway in Bangladesh, because his own is too crumpled. This volume is 757 pages long—and Mr Campbell is threatening to publish more. But as well as the index—frantically thumbed across London this week—to help guide readers to the sauciest bits, there are helpful subject lines at the bottom of each page, such as "Murdoch a hard bastard", "Chirac on nouvelle cuisine", "Shagger Cook a hero" and "Still no sign of WMD".

But the book is also telling in ways that Mr Campbell might wish it wasn't. His reputation for revolutionising the way government dealt with the media was probably overblown. Previous spokesmen, such as Mrs Thatcher's ("a silly old fucker", says Mr Campbell), had also cajoled the press. Nor are his methods defunct. David Cameron, the Tory leader, has just recruited another ex-tabloid journalist as his top spinner. Mr Brown has avowedly repudiated the old methods, but Labour's press apparatchiks still tend to be mini-Campbells wearing sharp suits and scowls. Yet for all that, Mr Campbell did sometimes go too far, as, for all the self-justification, his diary chronicles. He bullies cabinet ministers, obsesses over headlines, leaks to and manipulates journalists, almost all of whom he viscerally loathes:

> *Mr Blair: "God, the press will kill us for this."*
> *Mr Campbell: "Fuck them."*

Reader beware

When, not surprisingly, the hacks fight back, Mr Campbell only gets angrier—never more so than during his last and biggest battle, against the BBC over its claims that he had doctored the evidence of Saddam Hussein's arsenal. But, again, even as he protests his innocence of the BBC's specific allegation, the diary documents his real influence over the drafting of intelligence dossiers, which even now he cannot see was improper. He appears unconcerned by the fate of Iraq itself—unlike Mr Blair, who in this account is motivated by genuine anxiety about Saddam, as well as a conviction that Britain's interest lay in sticking with (and if possible restraining) Mr Bush. "It's worse than you think," Mr Blair says in 2002: "I actually believe in doing this."

So, like many diarists, Mr Campbell is an unreliable narrator. He is megalomaniacal and vain. He thinks Princess Diana fancies him ("there was something about her eyes that went beyond radiance", he writes, reviving the skills he honed in another former job, as a writer for a pornographic magazine). Everyone keeps trying to calm his misanthropic fury: his wife, Mr Blair, even Mr Clinton. Eventually, you sense that, sad and haunted as he is, the real target of Mr Campbell's ire is himself.

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Polls, wealth and happiness

Where money seems to talk

Jul 12th 2007
From The Economist print edition

AP

The rich are different from you and me—and they say they are happier

EVERY summer, the world has its temperature taken twice—once by climate scientists, literally; a second time by opinion pollsters, metaphorically. This year two new surveys have thrown up a lot of fresh data on how the world really feels. And they have, so the pollsters say, cast some unexpected light on the link between wealth and happiness.

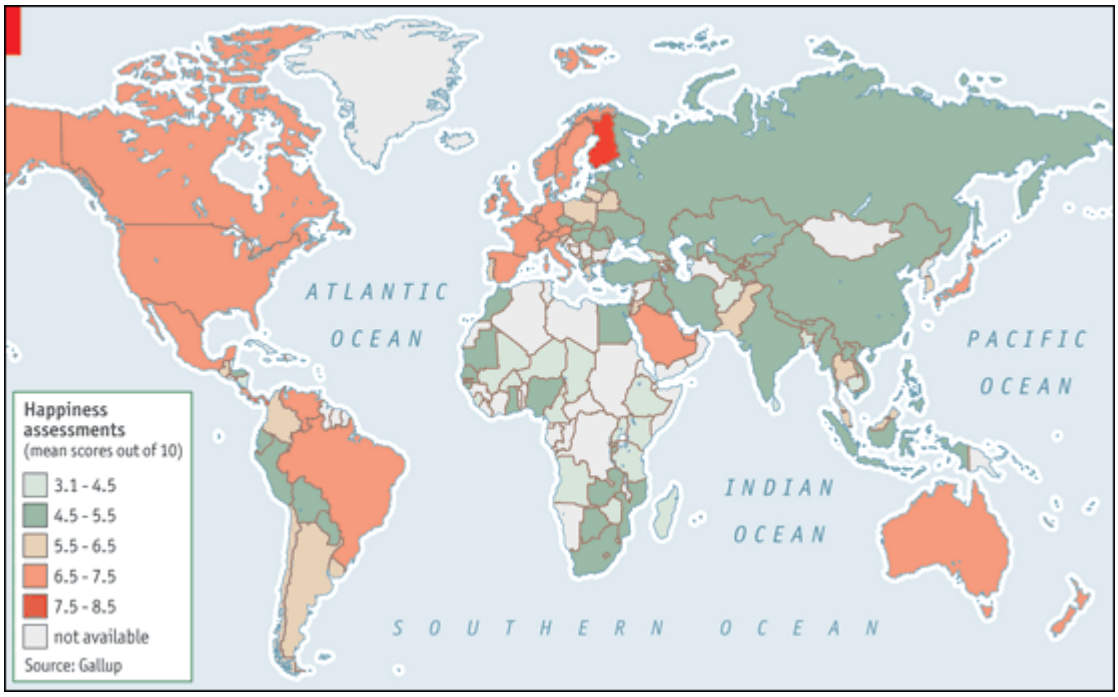
Ever since social scientists at the University of Pennsylvania found that mansion-dwelling American millionaires are barely happier than Masai warriors in huts, some economists have been downplaying the link between cash and contentment. In a 2005 book, Richard Layard, a British scholar, said family circumstances, employment and health all mattered more to a sense of well-being than income. Rich countries might be happier than poor ones, but beyond a threshold, the connection weakens, and more cash would not buy more happiness—so the theory goes.

The new polls cast some doubt on that school of thought. They add weight to the contention that growth and income play a big part in boosting people's satisfaction with life and their attitude to the future.

One of these surveys claims to be the first genuinely global opinion poll. Called World Poll, and conducted by the Gallup organisation, it spans 130 countries, many of which are being polled for the first time. Other surveys are smaller. The respected Global Attitudes Survey of the Pew Research Centre, an offshoot of an American charity, operates annually in just over 50 countries. The World Values Survey run from the University of Michigan is more comprehensive (over 80 countries), but updated only once in five years.

Gallup's pollsters asked a standard question: how satisfied are you with your life, on a scale of nought to ten? In all the rich places (America, Europe, Japan, Saudi Arabia), most people say they are happy. In all the poor ones (mainly in Africa), people say they are not. As Angus Deaton of Princeton University puts it, a map of the results looks like an income plot of the world (see map). There are some exceptions: Georgia and Armenia, though not among the world's poorest states, are among the 20 most miserable. Costa Rica and Venezuela, though middle-income countries, are among the 20 happiest. The Brazilians, pictured above, seem a bit more cheerful than their income level justifies.

But in general, declared levels of happiness are correlated with wealth. The pattern also seems to hold true within countries, as well as between them. Rich Americans are happier than poor ones; rich Brazilians happier than poorer ones.



The other new survey, by Ipsos, confirms the picture. Top of its list of 20 countries ranged by happiness is the rich Netherlands (with Gallup, it is Finland); China is bottom. The survey also asked questions about confidence in the future, whether your children will be better off than you are, and so on. Regardless of countries' current income, there was a close correlation between GDP growth and optimism, with China, India and Russia most optimistic; France, Germany and Italy were the least. If both polls are right, the Chinese are pretty miserable now but they expect a dramatic turn for the better.

The Ipsos poll is not strictly comparable to Gallup's because (for the first time) it asks questions of what Ipsos calls “leaders and shapers of public opinion”, mostly business people and politicians. This group has distinctive views—it takes a loftier view than the general population (see table). The gap between elite and popular perceptions is especially sharp in Russia, India and China. In those countries, top people's attitudes are far more upbeat than those of the general population. In Europe and America, the attitudes of the elite are roughly in line with—or slightly more pessimistic than—society as a whole.

In fairness, the “new happiness” economists, such as Mr Layard, never claimed there was no connection at all between money and feeling good. What they have said is that once people climb out of poverty, the link is weak, and may not work at all above a certain point (as one British pundit put it, extra money “is now proved beyond doubt not to deliver greater happiness, nationally or individually”). The evidence for this comes from surveys in most rich countries (such as America's general social survey), which show that happiness has been flat for decades, even though incomes have risen sharply.

The view from the top

Those *“satisifed with the way things are going”* in their country, %, 2007

Country	Elite opinion*	General population†
India	46	9
China	75	48
Russia	43	20
Brazil	15	11

Source: Ipsos *Ipsos polling †Pew Global Research polling

On the face of it, the new findings are a counter-point to the earlier data. If the richest countries report greater “happiness” than moderately rich ones, that would suggest there is no quantifiable level of income at which extra cash fails to deliver extra contentment. Still, the latest findings don't invalidate the historic experience of particular countries—like the United States—which have surged to greater levels of wealth without experiencing any rise in general levels of reported happiness.

But if you treat history as bunk and concentrate on the levels of satisfaction that countries feel right now, the results are—in Mr Deaton's view—quite striking. He has compared Gallup's satisfaction score with national income based on purchasing-power parities, and got a close fit.

So what should one make of the contradiction between these surveys and previous evidence? Definitional problems may provide part of the explanation. These are self-reported polls and people mean different things by “happiness”. Cultural problems are likely to be much greater when 130 states are involved.

Another possibility is that “happiness” is really a proxy for something else, such as health. Perhaps the main point is that money mitigates poor health, so the rich are happier than the poor mainly because they feel healthier. But that cannot be the whole story. More than half the 20 countries with the lowest level of satisfaction with health are in the ex-Soviet Union or eastern Europe though in statistical terms they seem relatively well off. In contrast, much poorer African countries (with a far higher incidence of HIV/AIDS and other diseases) express higher levels of health satisfaction. Expectations, or memories, may be at work: medical woes in an ex-communist state feel worse because people recall, albeit through rose-tinted spectacles, an era of full health coverage.

Lastly, as the Ipsos poll clearly shows, happiness and optimism are not just different, they can be contradictory. The Chinese are dissatisfied but upbeat; Europeans are happy now but dread tomorrow. Many links between happiness, income and optimism have yet to be teased out. This new data—though not the last word on the subject—should help.

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Religion and happiness

The fruits, and sorrows, of faith

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Belief clearly affects people's state of mind, but don't ask how

WHATEVER else they profess, most world religions say happiness is not as simple as it seems; earthly pleasures can easily prove to be a chimera, and true felicity is said to lie in overcoming selfish impulses, or in devoted service to others and to God. Where religions often disagree is on the result of this spiritual effort. Some speak of self-annihilation, others of union with God, others of a very personal sort of reward.

The Koran puts it simply. “Happiness in this life, and in the hereafter” is promised to “those who believe and lead a righteous life”—there is no other way. In the Christian tradition, there is much talk of joy and sorrow being intertwined: you can't have one without the other. Christian monastics cultivate a state known as *charmolypi*, joy-sorrow: tears for the woes of the world, and gratitude for God's mercy.

But on a more earthly level, sociologists agree that the practice of a faith and broad happiness with life do seem to be related, though nobody has much idea why. “We don't know whether people go to church because they are happy, or whether they are happy because they go to church,” says Andrew Clark, an economist who helped conduct a survey of 30,000 Europeans in 21 countries.

But if religion is a significant factor in making people satisfied, it should presumably show up somewhere in a global investigation of well-being, like the Gallup survey mentioned elsewhere on these pages. Dalia Mogahed, who oversees Gallup's research on Muslim opinion, has made some stark observations about that poll. There are, she notes, many Muslim countries where men and women alike are fed up with life. But of the ten places with the highest correlation between being female and (relatively) satisfied, nine are mainly Muslim: Afghanistan, Iran, Egypt, Turkey, the United Arab Emirates, Bangladesh, Palestine, Jordan and Morocco. Ms Mogahed says this reflects the travails of being a Muslim man as much as any blessings of being female. In traditional lands, where men expect to be breadwinners, many suffer the trauma of being jobless or doing hard, ill-paid work. Another factor, she thinks, is that one big source of female and child poverty in the West—single motherhood—hardly exists in Muslim societies.

Some may find such conclusions too complacent about the fate of Muslim women. Margot Badran, an American scholar of feminism in Islamic countries, says that in most of them there is a palpable sense of grievance among women. “But that doesn't imply that they are miserable, or consumed by victimhood—it just tells us we need a more nuanced picture of life than any simple spectrum of happiness can capture.”

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Business in America

Jam today

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From The Economist print edition

David Simonds

Worries about short-termism grip America's business elite—wrongly, perhaps

EARNINGS season is under way and America's best-known companies are queuing up to parade their second-quarter results. Alcoa kicked things off on July 9th and more than 200 companies will report during the week of July 16th alone. This quarter's earnings are expected to be rather unexciting; analysts think that profits at S&P 500 firms will grow by an average of just 4.4% compared with the same period a year ago. The bigger story lies behind the numbers, and the lengths to which managers will go in order to meet the market's immediate expectations. Consensus is growing that the issue of short-termism—an excessive focus on the next quarter at the expense of the longer term—is one that must be addressed.

In June the Aspen Institute's Corporate Values Strategy Group published a set of principles designed to "reassert long-term orientation in business decision-making and investing". Signatories to date include the Council of Institutional Investors, the Business Roundtable and other assorted bigwigs. A few days later the Committee for Economic Development (CED), a well-connected think-tank in Washington, DC, weighed in with "Built to Last", another report bewailing short-termism. These reports follow others in the same vein.

Why the furrowed brows? The problem is not new, but it is getting worse, says William Donaldson, a former chairman of the Securities and Exchange Commission and a CED trustee. The CED report lists several symptoms of growing short-termism, including increased levels of share trading, pay packages linked to short-term earnings, pressure from activist hedge funds and reduced tenures for bosses. The consequences include too much management time spent shaping analysts' expectations in the run-up to quarterly reports. More damagingly, say the worriers, short-termism leads to cuts in long-term investment.

A 2004 survey of chief financial officers by John Graham, Campbell Harvey and Shiva Rajgopal showed that a majority of managers were prepared to sacrifice a profitable long-term project to hit their quarterly numbers. American firms are still willing to think ahead: the country's research-intensive firms spend more on R&D as a percentage of sales than their equivalents in Japan, Germany and elsewhere. In the past accounting fixes, such as playing around with accruals, allowed executives to hit their quarterly targets while keeping up long-term spending. But now that such fiddles bear the stigma of Enron, says Mr Harvey, a professor at Duke University, long-term spending is more vulnerable.

The new reports suggest a number of ways in which executives can be encouraged to lift their eyes to the horizon. Getting rid of earnings guidance is a common theme. So too is providing better information about companies' long-term prospects. Tying compensation more tightly to the long term is another preoccupation. The Aspen Institute thinks that executives should be required to hold shares in their former employers for a period after they have left. It also advocates being able to claw back money from former managers if the accounts have to be restated.

Most of these ideas are unobjectionable. More detailed discussion of long-term plans can only be a good thing. The advantages of issuing earnings guidance are unclear. An analysis by McKinsey, a consultancy, shows that guidance has little obvious impact on either share-price valuations or volatility. Companies seem to be realising this for themselves. The latest guidance survey by the National Investor Relations Institute shows that increasing numbers of firms are opting not to offer it. But a study by Joel Houston, Baruch Lev and Jennifer Tucker in 2006 found no evidence that companies that stop issuing guidance increase long-term spending.

Crisis? What crisis?

The bigger question is whether the diagnosis itself is correct. “If short-termism is such a problem, how come this country is doing so well?” asks Mr Lev, an accounting professor at New York University. Another piece of McKinsey research into management practices at 4,000 firms across 12 countries, released on July 12th, concludes that American companies are the best run.

Some of the trends cited by the CED and others as evidence of short-termism are indeed unhelpful, if only to investors. Higher turnover in share portfolios boosts transaction costs and dents returns, for instance. But others are more to be welcomed than lamented. Take those near-sighted hedge funds. A 2006 study by Alon Brav, Wei Jiang, Frank Partnoy and Randall Thomas showed that activist funds generally outperform the market.

Nor are shorter tenures for chief executives necessarily a bad thing. According to research by Booz Allen Hamilton (BAH), a consultancy, North American bosses who presided over sub-standard returns in 1995 were as likely to have a lengthy stay in their posts as those who did well. By 2006, the mediocre performers had much less chance of chalking up a long tenure. “Performance has become a driver of tenure,” says Richard Rawlinson of BAH approvingly. But surely bosses at some firms need a while to prove themselves? According to Weber Shandwick, a public-relations firm, even bad bosses get a fair crack of the whip: the average tenure of departing North American bosses of big companies was longer than that of their European and Asian counterparts in 2006.

What of the argument that pay packages ought to be more geared towards the long term? Only if they are less geared towards time served. At almost two-thirds of American firms, executive pay packages include time-vested restricted stock—shares that can be sold only after a certain period but that, unlike options, have real value even if the share price falls. This rewards managers for staying in their jobs, but does little to encourage better long-term performance; grants of shares based on profit or revenue growth, for example, might be a better approach. Irv Becker of Hay Group, a consultancy, expects to see American pay packages move gradually towards such performance-based rewards.

Mr Donaldson, one of the critics of short-termism, says he is really calling for a better balance between the short term and the long term. As the debate gathers momentum and starts to head towards more sensitive ground, such as quarterly reporting itself, finding the right balance may require more people to speak up in favour of the positive aspects of short-termism.

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M&A in Japan

Land of the rising sums

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Japanese firms are wary of changes of ownership, but more are on the way

Get article background

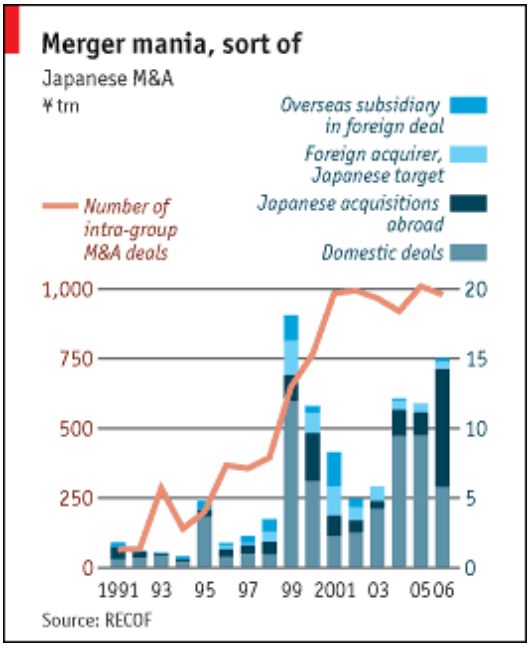
FOR evidence that Japanese companies are changing their attitudes towards mergers and acquisitions (M&A), look no further than last week's $900m unsolicited bid by Fast Retailing, a Japanese retail group, for Barneys New York, which had previously agreed to be sold for $825m to Istithmar, a Dubai investment fund. A year ago the Japanese corporate establishment flew into a tizzy when a big paper firm made a hostile bid for a small one; such things were not done in Japan's cosy business culture. Yet the current takeover bid, albeit for a foreign firm, shows that Japanese companies are starting to flex their financial muscles.

Japanese firms are typically averse to M&A. Companies have traditionally been regarded as social institutions as much as commercial ones—not things to be bought or sold, even if it makes economic sense. But this is changing. The number of M&A transactions involving Japanese firms has shot up over the past decade and their value reached 15 trillion yen ($129 billion) last year. Yet Japan still lags other big economies. The value of last year's deals was equivalent to around 3% of Japan's gross domestic product; in America and Europe the figure is typically around 10%.

The level of M&A activity and the ease with which deals can be done matter because such transactions enable corporate revitalisation, and the threat of being taken over keeps managers on their toes. For most of Japan's post-war history deals were rare and were orchestrated by the government or banks. Stable shareholders (such as banks) and cross-shareholdings between companies meant that gaining control was impossible without the consent of many stakeholders.

The economic downturn and heavy corporate debts in the late 1990s opened the door to M&A. A big but overlooked trend has been the growing number of M&A deals among subsidiaries within big corporate groups, notes Shoichi Niwa of RECOF, an M&A consulting firm in Tokyo. Conglomerates may have hundreds of subsidiaries in unrelated industries; they are a traditional place to park loyal executives once they reach 60, the usual retirement age, to give them a few extra years of work. Sony, for example, has a cosmetics line, restaurants and an insurance arm as well as its main electronics business.

Much of the intra-group M&A activity consists of companies bundling together disparate subsidiaries in the same industry in order to manage them better or sell them off. In this way, Japanese companies are using M&A as part of a broader corporate restructuring, says Steven Thomas of UBS, an investment bank. Adding to the momentum are new rules, which took effect in May, covering “triangular mergers”. The new rules let foreign firms use their shares to buy Japanese firms through local subsidiaries (though discriminatory tax rules have yet to be sorted out). This is expected to result in even more deals.



As the appetite for M&A increases, the Japanese model of stable shareholdings, once used to protect subsidiaries, may be used to get rid of them instead. Corporate parents, even those with minority stakes, enjoy *keiei ken*, or “management rights”, entitling them to set strategy and appoint managers. Last year Toshiba pushed a ceramics subsidiary out of the door via a management buy-out. Hitachi is shoving some subsidiaries away and merging others into its main business. In April All Nippon Airways agreed to sell its hotel and property-management units. And Matsushita, Japan's largest consumer-electronics firm, is in

talks with Kenwood, an audio firm, about a sale of its JVC brand.

Still, obstacles remain. Suspicion of foreign investors abounds: this week an appeals court upheld the anti-takeover defence set up by Bull-Dog Sauce, a food firm, against an American investment fund, Steel Partners, ruling that it was an “abusive acquirer”. In recent months over 300 firms have installed poison pills. The cultural hurdles are even higher. Selling a firm may be seen as an admission of failure. And although American and European executives can easily find work following a sale, Japanese managers often spend their entire careers at a single firm, and would have nowhere else to go.

Over the past decade the global M&A boom has enabled American and European companies to beef up. As Japanese firms looked inwards to clean up their financial problems, they were mostly left behind and now find themselves at a disadvantage in global markets. Economic malaise set Japan's M&A activity in motion. As its economy continues to improve, the dealmaking will only accelerate.

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European carmaking

Why Fiat is cool again

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The launch of the Fiat 500 crowns the Italian carmaker's comeback. But will it last?

FIAT knows how to throw a good party. An estimated 100,000 people celebrated the launch of the new Fiat 500 (known to Italians as the Cinquecento) in Turin on July 4th. The company flew in 7,000 people from 63 countries, including some 4,000 car dealers, 1,000 journalists and 100 financial analysts. Eight government ministers and assorted celebrities attended a show choreographed by Marco Balich, the creative director of the Winter Olympics in Turin. The car was displayed in the main squares of 30 Italian cities.

EPA

The president goes for a spin

The new Fiat 500's retro-chic styling has huge nostalgic appeal in its home country, where it is synonymous with *la dolce vita* of the post-war years, when the original Cinquecento motorised ordinary Italians. Yet the price tag, at €10,500-14,500 ($14,400-19,900), is hefty for a small car. Some observers question whether non-Italians will choose the new 500 over rival models made by Renault, Volkswagen and others—let alone BMW's even more expensive Mini.

Fiat's top brass, however, has few doubts. “After three cathartic years to turn around the group, this is not the launch of a car, but the launch of Fiat,” gushed Sergio Marchionne, who took over as boss of the Fiat group in 2004. For John Elkann, vice-chairman of Fiat and representative of the dominant Agnelli family's interests, the revival of the little car exactly 50 years after the launch of the first Fiat 500 was nothing less than “a new beginning”.

For once, this may not just be management hype. Only four years ago Fiat, Italy's biggest industrial group, had the look of a company that had given up the will to live. So sickly was its auto division that without a €3 billion ($2.8 billion) bank bail-out in 2002, the group would have faced bankruptcy. Between 2001 and 2004, the firm lost €8 billion on its car business, which includes great names such as Alfa Romeo, Lancia, Ferrari and Maserati. At this low ebb, Fiat's chairman, Umberto Agnelli, brother of the legendary Gianni, who had died the year before, succumbed to cancer—but not before identifying Sergio Marchionne, a 52-year-old Italian-Canadian, as the man to inject new life into Fiat.

Since taking over in 2004, Mr Marchionne has been both effective and lucky. He has cut costs, laid off workers (not easy in Italy), increased the sharing of components between models and formed alliances with other carmakers to speed development. (The new 500 shares a floorplan and many components with the Fiat Panda and the new Ford Ka, due next year.) He extracted €1.55 billion from General Motors in 2005 as compensation for unwinding an ill-considered put option to buy Fiat's car business. But his biggest stroke of luck was that even before his arrival, Fiat had once again started to make cars that people wanted to buy, such as the new Panda in 2003 and the Grande Punto in 2005. Earlier this year its European market share ticked up to 8.5%.

The new 500 raises Fiat's game further. Some analysts have questioned the impact it will have on Fiat's future, arguing that it is a niche model that will be built at a rate of “only” 120,000 cars a year. But the reaction of the usually hard-bitten motoring press suggests otherwise. In recent years no small car, not even the new Mini (designed by Frank Stephenson, the man behind the new 500), has been greeted with such enthusiasm.

But as Fiat itself shows, fortunes in the car industry can turn with extraordinary rapidity. Fiat hopes to maintain its winning streak by introducing over 20 new models by 2010. Yet it needs to be careful. Its brand is not yet strong enough to absorb more than a couple of slip-ups, and the re-launch of Alfa Romeo in America will be difficult and expensive. So is the 500 a dazzling digression, or confirmation that Fiat is back? With small cars back in fashion, the betting is on the latter.

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French industry policy

Getting better?

Jul 12th 2007
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President Sarkozy's supposedly liberal tendencies are put to the test

Get article background

CAN there be cause for cheer in a pot of yogurt? Perhaps there can. Two years ago Franck Riboud, the boss of Danone, a French food group, was able to whip up a froth of economic nationalism to ward off the mere threat of a takeover by America's PepsiCo. The prime minister at the time, Dominique de Villepin, took it as his cue to talk about a list of strategic industries that would remain forever in French hands (though not even he actually put yogurt in that category). Yet no one in France objected last week when Danone sold its biscuit unit to another American food giant, Kraft, and then announced plans to spend the proceeds buying Royal Numico, a baby-food company based in the Netherlands. The only grumbles came from analysts worrying that Danone might be paying too much.

It is heartening to interpret the relaxed official attitude to Danone's sale as an indication that French politicians, led by their new president, Nicolas Sarkozy, are moving away from knee-jerk nationalism whenever a foreigner wants to buy a French company. This would be no more than a reflection of the quiet internationalisation of French business, since hundreds of small and medium-sized firms are snapped up each year by foreigners. One French worker in seven now works for a foreign company (twice the number ten years ago) and a third of exports are produced by foreign-owned companies.

But two long-running industrial sagas, in energy and aerospace, still provoke plenty of political interference. The proposed merger of Suez, a privatised water and power utility, with state-owned Gaz de France, has been bogged down since February last year, when it was suddenly cooked up to fend off a hostile bid for Suez by Enel, an Italian energy giant. Now the French government seems keen for another state power firm, EDF (rather than any foreigners), to buy the bits of Suez that it will have to sell to address competition concerns raised by the European Commission. This looks like yet more meddling, but it could at least smooth the path of Gaz de France's much-delayed privatisation.

The power struggle at European Aeronautic Defence and Space (EADS) has worsened in the past two years as its biggest operation, Airbus, has been hit by delays to its new aircraft models and a weakening dollar. (Airbus's costs are mostly in euros, and its revenues in dollars.) Mr Sarkozy will hold talks with Angela Merkel, the German chancellor, at Airbus's Toulouse headquarters on July 16th in the hope of finding a way to replace its clumsy bicephalic leadership with a simple line of command that nevertheless does not upset French or German sensibilities.

Mr Sarkozy is right to insist that any deal should not interfere with Airbus's difficult recovery plan. He has said often that the French state (which still owns 15% of EADS) should sell its stake eventually. The trouble with moving from interventionist industrial policy to a hands-off, liberal approach is that you have to intervene, and get your hands dirty, to get from here to there. But at least Mr Sarkozy has got his sleeves rolled up.

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Economist.com BUSINESS

Vertical search-engines

Know your subject

Jul 12th 2007
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Topic-specific search-engines hope to challenge Google, at least in some areas

ARE you a generalist or a specialist? The question can be asked of people, but it is increasingly being asked about internet search-engines, as specialist or "vertical" sites take on generalists such as Yahoo! and Google. Some are already prospering: GlobalSpec.com, for example, a profitable search-engine for engineers, has 3.5m registered users and signs up another 20,000 each week. "They own that market," says Charlene Li of Forrester, a consultancy.

This is due in large part to GlobalSpec's definable customer base. Its knowledge about the needs of its users sets it apart from the generalist search-engines, says Angela Hribar of GlobalSpec. Vertical sites, which serve up search results from a carefully selected group of topic-specific websites, can also target advertising at particular audiences more precisely.

One promising area for vertical sites is health-related search, which provides a microcosm of the threats and opportunities facing specialists. At stake are the online advertising budgets of the pharmaceutical and health-care giants, which are expected to spend $1.4 billion on online advertising in America alone next year, up from $625m in 2005. According to Jupiter, a consultancy, nearly a quarter of American internet users say the web is essential to taking care of their health. "The market opportunity for health-search is very large and growing," says Alain Rappaport, the boss and founder of Medstory, a health-search site based in Foster City, California.

Health is a field where consumers do seem prepared to seek out specialist sites that provide more relevant results. According to a new study from Jupiter, to be published on July 16th, 65% of health-search users believe that relevance is the most important criterion when deciding whether to click on a particular result; only 16% rate the trustworthiness of the source as most important. In short, relevance is king, says Monique Levy of Jupiter, which suggests that a vertical search-engine that successfully pairs a broad target market with a complicated topic can do well.

But that will mean getting consumers to kick their existing search habits. A study by the Pew Internet & American Life Project, a non-profit research group, found that two-thirds of Americans researching health-related topics online started with a general search-engine. Only 27% went on to a medical site of any kind, let alone a health-search site. "The path to general search engines is well-worn and familiar," says Susannah Fox of Pew. "Dr Google is the de facto second opinion in this country."

Even so, there are signs that consumers are warming to the special features that specialist search-engines offer. Healthline, a health-search site with a "symptom search" function, saw its number of unique monthly visitors increase nearly sevenfold during 2006 to around 2.5m. Some sites, such as Healia, can limit results to those written at a "basic reading" level. Others, such as Mamma Health, limit results to pre-screened medical sources. The same sorts of ideas are also being applied in other vertical-search fields.

At the same time, however, similar features and filters are appearing on generalist search-engines, enabling them to act more like vertical engines. Search for "achondroplasia" at Google or Yahoo!, for example, and you will be steered towards results sorted under the headings of treatments, causes, research and so on.

All of which suggests three possible fates for vertical-search sites. The strongest may be successful enough to dominate specific categories. The weakest may be picked off by pseudo-specialist features added to generalist search-engines. And there is a third way, namely for specialist sites to be offered under a bigger brand's umbrella. Last month Meredith, an American publisher of magazines such as *Fitness* and *Parents*, bought Healia. And Microsoft, which lags behind Google and Yahoo! in generalist search, hopes to use vertical search to fight back. It has bought several vertical sites in recent months—including Medstory in February. Health-search sites suggest a similar prognosis for specialist sites in other

fields.

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Digital cinema

The final frontier

Jul 12th 2007 | LOS ANGELES
From The Economist print edition

How digital technology is changing the way cinemas work

THERE is a scene in “Transformers”, a blockbuster that came out last week, in which a mobile phone turns into a homicidal robot. In its astonishingly loud way, the film is a meditation on the dangers posed by advanced technology. So it is appropriate that a new-fangled system was not trusted to handle the film during its premiere in Los Angeles. In the projection booth, two machines whirred: a digital one, which in the event worked perfectly, and an old-fashioned celluloid one, which was on hand in case the more advanced technology became unruly.

Despite such fears, a rapidly growing number of cinemas are going digital. Over 3,000 North American screens have been converted, nearly two-thirds of them in the past year. Some download films and advertisements via satellite, and others have films delivered on hard drives (which are a lot smaller, lighter and cheaper than big reels of film). America's biggest chains, which have lagged behind, will start to convert cinemas next year. And Europe, which has trailed even further, should catch up thanks to a deal announced this month with two Hollywood studios.

One reason for the growth is that, two years ago, the studios agreed on technical standards for digital projection. Another is that a reassuring business model has emerged. By means of “virtual print fees”, the studios pass on much of what they save in not having to print and deliver those heavy reels of film. That subsidises the cost of installing digital projectors. But the main reason cinemas are going digital is that they are desperate for an edge.

Thanks to a building boom in the past few years, there is a glut of cinemas. America now has some 40,000 screens—a third more than a decade ago. Last year each was watched by just 100 pairs of eyes each day, on average. And most of those eyes turn up on Friday and Saturday nights. The rest of the time, some of the world's most valuable property sits almost empty.

The cinemas' problem is the opposite of that faced by art galleries, theatres and opera houses. Such highbrow outfits tend to have small, select clienteles and are constantly trying to broaden their appeal, often by offering discounts and staying open late on Friday and Saturday nights. Cinemas already have mass appeal and weekend crowds—so in order to bring in more punters, they must entice people with more select tastes.

Digital technology makes that easier, since it allows the transmission and display of live, high-definition images. Last season the Metropolitan Opera House in New York beamed six performances live to cinema audiences. It was an unexpected success, luring 324,000 punters who each paid more than twice the cost of an ordinary film ticket. *Variety*, a trade magazine, estimated that “The Barber of Seville” would have made its top 20 films of the week—not bad for something that appeared on fewer than 300 screens.

More of the same is promised. And Bud Mayo of Access IT, America's biggest digital-cinema firm, reckons music is just the start. He imagines people watching lectures in cinemas. As Mr Mayo points out, cable television provides enormously varied fare; the key to its success is that people know where to go to satisfy their peculiar tastes. If people can get used to the idea that their local multiplex shows something other than flying superheroes and dysfunctional families, those empty seats should fill up.

Digital technology has also been touted as a lifeline for independent film-makers, who struggle for attention in sequel-laden summers such as this one. Since the cost of digital distribution is almost zero, the thinking goes, cinemas ought to gamble on more obscure products. But Amir Malin of Qualia Capital, an investment firm specialising in film, doubts it. He reckons digital technology is more likely to increase the heft of blockbusters.

He may be right. If an unexpectedly large gaggle of teenagers turns up to see a Saturday-night showing of “The Simpsons Movie”, say, an old-fashioned cinema must either lug reels of film around or run a single

film through two adjacent projectors. A digital cinema, on the other hand, can shuffle films and show times with abandon. Perhaps the biggest single benefit of digital technology is that a popular film need never sell out.

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3-D films

Looking more convincing

Jul 12th 2007
From The Economist print edition

True believers reckon 3-D is the next big thing. They might be right this time

EVER since the first mass-market 3-D movies introduced audiences to monsters flying above their seats in the 1950s, the genre has been better known for eyestrain than for thrills. The experience of David Heyman, the producer of the Harry Potter films, was typical: watching a 3-D movie six years ago “gave me a headache”, he says. But today Mr Heyman, like many in Hollywood, is betting that improved technology is ready to give 3-D a better image. Mr Heyman's new film, “Harry Potter and the Order of the Phoenix”, released this week, will be shown in some cinemas with a 20-minute 3-D finale.

Eliminating headaches involved developing and refining display techniques with names such as circular polarisation, stereoscopic image-capture and temporal multiplexing. In the most elaborate system, called Real D, images for the left and right eyes are projected alternately by a digital projector running at 144 frames per second; clear, specially polarised glasses then ensure that each eye sees the appropriate image.

The resulting viewing experience is “a lovefest”, says Catherine Owens, co-director of “U2 3D”, a movie of the band's Vertigo tour that will be released exclusively in 3-D in the autumn. For a high-fidelity rendition of the concert experience, she says, only the “sculptural quality” of 3-D will do.

Many of Hollywood's big names are betting on the new 3-D technology. Peter Jackson, the maestro of “The Lord of the Rings” films, is collaborating with Steven Spielberg to make a trilogy of 3-D movies about Tintin, a Belgian comic-book hero. James Cameron and Robert Zemeckis have 3-D films in the pipeline. DreamWorks Animation, creator of the “Shrek” movies, says all its films will be in 3-D from 2009.

Making 3-D movies is not expensive, in Hollywood terms at least. Adding a third dimension to a conventional live-action film costs $5m or so; for an animated 3-D film, it costs an extra $15m. But industry experts reckon that animated movies are where the biggest profits lie, at least initially. Animation fans in particular expect cool effects, and 3-D makes possible all sorts of new tricks, notes Martin Levy of DreamWorks. “It's something that adds one more layer of reality to the unreality,” he says.

According to Screen Digest, a consultancy, 3-D films can earn three times as much revenue per screen as 2-D versions on their first weekend. They are also immune to piracy: point a hand-held video camera at the screen and it will capture only blurry, 2-D images. And even the most advanced home-cinema system cannot do 3-D, which gives people a new reason to go out to the cinema. The number of 3-D screens is small, but rising. Screen Digest says the number of digital 3-D screens will go from 750 today to 5,000 by 2009. This time around, the case for 3-D appears to be solid.

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Face value

Leader of the swarm

Jul 12th 2007
From The Economist print edition

UPPA

Christopher Hohn, like his hedge fund, is powerful, feared—and generous

Get article background

THIS summer's Exchange Forum, an industry event attended by Europe's top stockmarket operators, was a strange place to see Christopher Hohn, the founder of The Children's Investment Fund (TCI). Mr Hohn is reclusive by nature. By agreeing to speak at the forum he was appearing not just in public, but before a potentially hostile crowd, since his hedge fund, based in London, has a history with financial exchanges. In 2005 TCI played a prominent role in derailing an offer from Deutsche Börse for the London Stock Exchange (LSE), which led to the ousting of Werner Seifert, the German exchange's long-serving chief executive. Mr Seifert recounted the story in a book, “The Invasion of Locusts”, and popularised a metaphor that is now widely used by critics of activist investors. He was particularly scathing about Mr Hohn, who could justifiably, if he wished, claim to be one of the leaders of the swarm. More recently, with $1 billion invested in ABN AMRO, Mr Hohn instigated a sale of the sprawling Dutch bank. A takeover would be the largest bank deal ever and a striking demonstration of Mr Hohn's deal-making influence.

Having rumbled on since February, the ABN AMRO saga was expected to reach a turning point this week with a ruling from the Dutch Supreme Court on July 13th. TCI favours a takeover proposal from a consortium led by the Royal Bank of Scotland, but the Dutch court may tilt the balance in favour of a lower, all-share bid from Barclays. Either way, the prolonged takeover battle has been a successful investment for Mr Hohn. But it has thrust him into the media spotlight and heightened concerns about the way in which activist investors can determine the fate of the world's largest corporations.

This attention can be useful when it comes to TCI's activism. Often with relatively small ownership stakes, the fund calls for share buybacks financed with debt, management changes or an outright sale. Mr Hohn rarely speaks to the press himself, but instead makes his views known in the financial press via articulate spokesmen. His wide-ranging campaigns—stretching from America, where TCI takes issue with the capital structure of railways, to Japan, where it is calling for corporate-governance reforms—often catch less media-savvy bosses on the hop. Mr Hohn's skilful choice of investments and successful campaigns for change have provided returns of more than 40% in each of the past three years. But more remarkable than the returns is the combination of ruthless profiteering and philanthropy which TCI represents. Its origins lie in Mr Hohn's background.

The son of a Jamaican car mechanic, Mr Hohn studied accounting and economics at Southampton University, in England, and then took a banking job in the Philippines. While working there he saw

children scavenging on rubbish dumps for food, and the image stayed with him. Mr Hohn went on to attend Harvard, and from there he worked his way up the Wall Street ladder, ending up under the tutelage of Richard Perry, a renowned hedge-fund investor, at Perry Capital. For seven years, Mr Hohn produced outsized returns while managing $1 billion in assets for European investors.

Like many fund managers Mr Hohn eventually decided to go it alone, but he had a novel approach. Over dinner at a London restaurant, he and his wife Jamie Cooper-Hohn—who studied public administration at Harvard and then worked for various charitable organisations—cooked up a plan to combine her philanthropic expertise with his financial acumen. They came up with a hybrid structure: a hedge fund that would channel a proportion of its fees and profits into a charity. Bankrolled by pension funds, insurers and prominent universities such as Yale, Mr Hohn set up TCI, and its related charity, the Children's Investment Fund Foundation (CIFF), in 2002. The fund now has about £5 billion ($10 billion) under management, and $1.4 billion has already been allocated to the CIFF, making it one of Britain's biggest charities. As its name suggests, the CIFF concentrates on funding health-care and education programmes for children in the developing world. Last year Mr Hohn donated £230m to the foundation, making him Britain's most generous philanthropist.

Doing good by being right

Charity and rapacity sit surprisingly comfortably together, both in Mr Hohn's person and in his business. He has never gone in for the trappings of wealth. He seems driven less by greed than by a desire to be proved right, and to win. In his book, Mr Seifert writes that Mr Hohn “collects money the way others collect trophies”. He likes to win arguments, in other words; and the money is simply evidence that he won.

The desire to prove himself right was on show when Mr Hohn took the stage at the Exchange Forum. In the question-and-answer session, a member of the audience likened the 40-year-old Mr Hohn to a 16-year-old driving a Lamborghini, and then pointed out that LSE's share price had nearly doubled since Mr Hohn coerced Deutsche Börse into abandoning its offer. Mr Hohn ignored the personal attack and focused on winning the argument. He pointed out that the German exchange, which followed TCI's advice and undertook a share buyback, had seen its share price increase fourfold over the same period.

Anyway, charity may be good for business. Not that there is any doubt of Mr Hohn's sincerity—close friends say he is passionate about his charity in private—but his philanthropy may prove useful protection. The commercial success of active investors, in the form of both hedge funds and private equity, has made them politically vulnerable. Attacks on the locusts have spread from Germany to Britain, America and Japan over the past year; trade unionists, politicians and journalists have called for their activities to be restricted. In this atmosphere the decision to funnel TCI's profits to the poor looks less like an act of insane generosity than a remarkable piece of far-sightedness.

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Germany's economy

Back above the bar again

Jul 12th 2007 | BERLIN, FRANKFURT AND LEIPZIG
From The Economist print edition

EPA

Europe's biggest economy is performing strongly, but structural problems persist

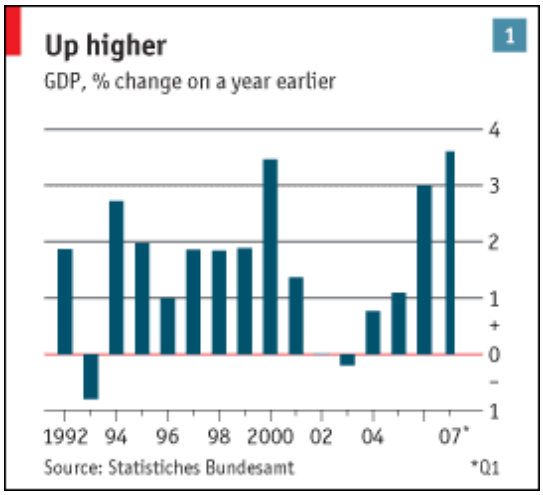
Get article background

AT THE start of last year Frank Lüngen had 500 vacancies on his books. By the end of it, the employment agency he runs in the eastern German town of Rosslau had 1,000 jobs to fill. Companies are complaining of a shortage of skilled labour, he says: there just aren't enough good people to go around.

Mr Lüngen's story is a typical one in the recovery of Europe's biggest economy. Germany had been ailing for a decade after post-reunification euphoria gave way to an almighty hangover; an upturn at the end of the 1990s was followed by deeper gloom. But now the colour is back in its cheeks again.

GDP grew by almost 3% last year, the fastest rate since 2000, and may do as well in 2007. It managed 3%-plus in the first quarter (see chart 1), despite a rise of three percentage points in value-added tax (VAT). This month *The Economist*'s poll of forecasters showed prospects for the German economy were improving, with an average prediction for GDP growth in the year of 2.8%, sharply up from 2.3% in May.

In the past few years the main motor of growth has shifted. When the economy was at its weakest, in 2002 and 2003, exports kept it running. They continue to do well—in manufacturing exports, Germany is *Weltmeister*, or world champion, again. But for some time more oomph has been coming from domestic demand, chiefly investment. Construction—a drag on growth for a decade, after the post-reunification binge—has also picked up.



Even consumers, who once seemed determined to keep their wallets shut until doomsday, may be joining in. According to Klaus Fischer, of the retailers' federation in Berlin and Brandenburg, shop revenues in and around the capital fell for 13 straight years until 2005. Since then they have stabilised. At national level too people seem a bit keener to spend, despite higher VAT. Consumer confidence has rebounded.

Consumers are being buoyed by the labour market. More Germans have been working and, after years of wages trailing behind prices, pay packets are at last getting a little fatter. Confusingly, Germany has two definitions of unemployment, and both rates are falling fast. On the basis used by the Federal Labour Agency, unemployment was 9.1% in June, down from 10.8% a year before; on the International Labour Organisation's definition, which is comparable with other countries' figures, the rate was 6.4% in April, down from 8% 12 months before. That is well below France's 8.1% and not so far above Britain's 5.5%.

In the past year employment (on the agency's figures) has risen by 570,000. Unemployment has been falling faster still, partly because some people have left the register as jobless benefits have become more closely tied to jobseeking. Michael Burda, an economics professor at Humboldt University in Berlin, points out that in western Germany the number of unemployed has rarely fallen so far, year-on-year, since the late 1960s.

The obvious question is whether all this is merely a cyclical upswing or whether Germany has undergone some deeper, structural change. The obvious answer—too early to tell, but most likely a bit of both—is probably correct.

Start with the case for caution. If, as seems likely, Germany is close to the peak of an economic cycle, its recent record, though encouraging by past standards, is scarcely spectacular. It follows that its sustainable growth rate is less impressive still. Thorsten Polleit, an economist at Barclays Capital in Frankfurt, estimates that trend growth has been declining steadily for decades and is now only around 1.5%. “Has Germany's growth potential gone up?” he asks. “I don't think so.”

The rapid increase in employment can also be viewed from a less flattering angle. From the bottom of the cycle, in mid-2003, employment grew much less quickly than in previous upturns. And much of the early rise took the form of “mini-jobs”—part-time posts paying no more than €400 ($545) a month, regardless of hours (see chart 2). By contrast, employment in the “primary” labour market, where social insurance contributions are compulsory, is still well below what it was seven years ago (see chart 3). Unemployment is still around 4m. And the rate in eastern states is still double that in the west.

Open more hours

Nevertheless, something structural has shifted. Some of the changes are unmissable. On the high street, most restrictions on shopping hours have been swept away, although Sunday trading remains mostly illegal (railway stations, airports and petrol stations are important exceptions).

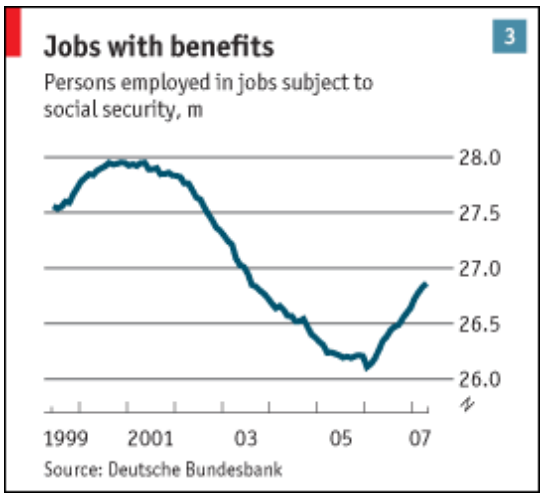
Slightly less obvious are the changes in corporate Germany's balance sheets. In essence, capital used to be cheap; the cost of it has now gone up. State guarantees for public-sector banks have gone, removing an implicit subsidy for their loans. The arrival of the Basel 2 accord on bank-capital requirements has forced banks to price their loans according to risk.

More is being demanded of equity capital too, even if German corporate governance still leaves something to be desired. Financial institutions have run down their old stakes in industrial companies—which were valued for cementing corporate relationships rather than as financial assets. Much of Germany's complicated network of cross-shareholdings has now been dismantled. Those stakes that remain are expected to produce a decent return. Meanwhile, a new, more demanding species of shareholder has appeared in the form of private-equity firms, which Franz Müntefering, a Social Democratic minister, once notoriously described as “locusts”.

The shifts in the labour market have been just as important as those in the market for capital. Partly, they are the product of reforms undertaken three or four years ago. They brought forth all those mini-jobs, stiffened the terms for unemployment benefit and made life easier for private employment agencies, like Mr Lüngen's, and temporary employment firms, such as Switzerland's Adecco, America's Manpower and the Netherlands' Randstad, now the market leader, as well as lots of home-grown German rivals.

Zeitarbeit, as temporary work is known, accounts for 1% of all jobs, but for perhaps more than half of all those created in the past year. One example of the new breed of employers is time & more, which specialises in health care. It has around 400 people on its books, of whom 300 are nurses; two years ago it had 250. Its founder, Bernd Sydow, who sold his firm to Adecco in April, says that it supplies almost all Berlin's hospitals as well as hospitals in other big cities. Around three-fifths of time & more's nurses are called on for stints of one to three days, often at

short notice. Having reduced permanent staffing levels and carrying no reserves, hospitals turn to the agency as their requirements fluctuate. Mr Sydow reckons that eventually about 5% of his clients' nurses will come from an external pool.



Agencies such as Mr Lüngen's, in contrast, do not employ those for whom they find work, as *Zeitarbeit* firms do, but act as brokers. Last year such firms filled 62,000 jobs in the primary labour market, three times as many as in 2002. As well as running his own agency, Mr Lüngen runs his industry's biggest trade association (there are a handful), whose membership has risen from 23 when it was founded in November 2003 to more than 200.

Regulatory reforms explain only part of the change in the labour market. As companies have come under more pressure, workers' pay has been squeezed: as higher returns on capital have been demanded, the relative price of labour has had to fall. That managers can threaten to move work to central Europe or even farther away has strengthened capital's hand. As a consequence, while company profits have risen steeply, workers have done much less well. In the past six years, the share of wages in national income has fallen from around 60% to little more than 55%.

In part, this has come about through a loosening of Germany's system of industry-wide wage deals between employers' representatives and trade unions. This corsetry was never quite as rigid as it looked: variations on centrally struck wage deals at local level and in individual companies were already part and parcel of it.

However, agreements have become more flexible, notably since 2004. Martin Leutz, a spokesman for Gesamtmetall, the engineering employers' federation, refers to a “huge breakthrough” in that year's wage round, allowing companies to deviate from agreed terms on pay, bonuses and hours if this would secure or create employment, or keep investment in Germany that would otherwise go elsewhere—albeit with the agreement of workers' representatives. More and more companies, especially in eastern Germany, have chosen to bypass the central system altogether.

Moreover, negotiated settlements have been modest. Actual pay rises, indeed, have lagged behind inflation for several years. This year it looked as if labour might at last regain some of its old bargaining power, at least in the metal industries. IG Metall, the country's biggest union, demanded a 6.5% rise from the end of April. When Gesamtmetall said no, the union called short warning strikes.

The eventual settlement, reached in early May, covers 19 months, promising 3.9% in the first year and a further 2.1% in 2008, which can be postponed for up to four months. The average annual cost for the duration, according to Gesamtmetall, is 3.3%. That was the unions' best result for several years. With inflation at 1.9% it amounts to a real increase. But not a big one; and the metal industry has been doing particularly well, with export demand riding high. Workers elsewhere are unlikely to see their pay rise by as much.

At BMW's ultra-modish factory in the eastern city of Leipzig, where the line of 3-series saloons heading for the paint shop is visible high above the reception area, the effects of both sides of this new labour market are on show. BMW pays its Saxon employees, who turn out a car equipped to an individual customer's order every 80 seconds, according to the national contract. But they get fewer of the extra payments on offer to those at the carmaker's Bavarian plants, in Regensburg, Dingolfing and Munich, thinning their wage packets by about 25%. Lots of flexibility is built into shift patterns, explains Michael Janssen, a company spokesman—for example, extending shifts by 30 minutes, adding extra ones or rearranging lots of them at short notice. Parts of the factory can be run for 140 hours a week (Sunday work is illegal, so that is pretty much the lot).

At the same time, BMW has made liberal use of *Zeitarbeiter*. In all, 5,200 workers are on the site, of whom 2,500 are employed by BMW. Of the rest, about 1,300 are temps; soon there will be at least 300 fewer, as *Zeitarbeiter* used by a company contracted to assemble doors are taken on to the supplier's permanent staff.

You might imagine that the temporary workers, like the nurses employed by time & more, are called in when demand is high and sent away when it slackens. But according to Mr Janssen, this is not BMW's reasoning. Over the next ten to 15 years, the company will not need the same workforce as it does now.

Rather than take people on and let them go—"it's always a mess in the future"—the company would rather not take them on at all. That could be interpreted as a reference to the *Kündigungsschutz*, the legal protection against dismissal that can make firing workers costly, but Mr Janssen puts it differently. "It's not BMWphilosophy to hire and fire," he says. "Our philosophy is to guarantee jobs."

Them and us

Perhaps predictably, the terms of *Zeitarbeit* have caused resentment among temporary workers and some controversy in the press. Largely, this is because pay is lower, even though (in true German fashion) temporary workers are subject to their own centrally negotiated wage contract between agencies and trade unions. *Zeitarbeiter* at BMW in Leipzig get around 75%, on average, of the pay of the factory's permanent employees. (The cost to the company is rather more than that, because it must pay the agency its cut, on top of the slice that goes to the workers.) But little things can bruise too. One former temporary worker at BMW recalls that whereas permanent staff get a €1 discount on meals in the canteen, *Zeitarbeiter* must pay full price. Not much of a slight, you may say, and when unemployment is still high surely any job is welcome; but such things can sting all the same, especially when a temp's wage is lower to start with.

This pressure on wages is, not surprisingly, reflected in a marked improvement in German industry's competitiveness. Unit labour costs in manufacturing, which soared in the early 1990s, are now back to around where they were at reunification (see chart 4). Since 2001 Germany's unit labour costs have fallen by around 20% relative to Italy's and Spain's.

Viewed another way, however, this is as much a reflection of an old German virtue as of a new one. In the days before monetary union, German business time and again sharpened its blade on the hard stone of a strong D-mark: to get France and Italy, in particular, out of trouble, devaluations of the franc and lira were dressed up as revaluations of the D-mark. In the euro zone, however, national currencies no longer exist, so nominal national exchange rates cannot change. Real rates can be devalued—but only through having a lower inflation rate than other members of the club. Since the euro was born, the Germans have proved themselves as competitive as they ever were. Unable to devalue, others have fared less well.

That said, it would be a mistake to ascribe all of Germany's renewed economic strength to export competitiveness created by wage restraint. For one thing, although exports kept the economy going when domestic demand was truly feeble and although foreign sales have carried on apace, investment and construction are now pulling more of the weight. For another, changes in relative prices within the euro zone explain only so much.

According to research by economists at the Bundesbank, the growth of overseas markets is more important in explaining the growth of Germany's exports than is price competitiveness—although prices play a bigger role in the euro area than they do outside it. By luck or by judgment, Germany is in the right businesses at the right time: China, India, Russia and other countries in central and eastern Europe are growing fast and wanting the goods in which Germany specialises. Indeed, exports to Russia and other European countries to Germany's east now exceed those to the United States.

AP

All those years of training

Orders for machine tools, for instance, have been growing by more than 10% for the last three years and have been at their strongest for 30 years. In a study of 25 countries by economists at Goldman Sachs, the correlation between the imports of Brazil, Russia, India and China and Germany's comparative advantage (revealed in the structure of its exports) was bettered only by those for America and Finland. Southern and central European members of the European Union were worst placed. Dirk Schumacher, of Goldman's Frankfurt office, thinks that Germany is well placed to benefit from growing interest in environmentally friendly technology. With America, Germany is the leading exporter of goods of this type.

Things to do

It is clear that Germany's economy is now whirring after years of idling. Given the shock (and cost) of unification—absorbing the former East Germany added 25% to population but precious little to output—that is quite an achievement. Yet it would be easy to become too starry-eyed over Germany's recovery.

The world economy has been exceptionally strong in recent years, and the euro area was due for a cyclical upturn. At some point the cycle will surely turn again. It is not hard, either, to make a strong case for further structural reform. The banking system remains fragmented, split among private, state-owned and co-operative institutions between which consolidation is difficult, if not impossible. The labour market, for all its improvements, still needs further reform. Like other European countries, Germany has loosened the periphery of its labour market but not the core. For example, the *Kündigungsschutz*—under which many dismissals end up in front of special labour courts—makes the costs of firing both high and uncertain, and thus deters hiring.

It would be as mistaken to get carried away by Germany's revival as it was to write the country off earlier in the decade. Some rebound was sure to happen and German business is looking in exceptionally good shape. But without further reform, some of the old obstacles to employment and growth could yet re-emerge.

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Debt markets

Another pounding

Jul 12th 2007
From The Economist print edition

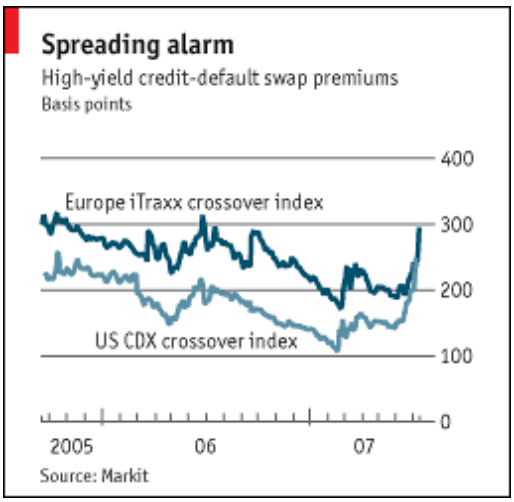
Satoshi Kambayashi

Problems in America's housing market begin to undermine confidence in the global credit bubble

WHEN the man approaching you is wearing boxing gloves, it makes sense to duck. The crisis in the American subprime-mortgage market was clearly visible months ago. Too many homebuyers with a poor or non-existent payment record were lent too much money. But when the rating agencies on July 10th finally got round to acknowledging the problem, investors were clobbered. Shares briefly wobbled and the dollar sank. Swap spreads, a measure of risk aversion, reached their highest point since 2003. Credit derivatives, where much of the financial innovation in recent years has taken place, recoiled (see chart). Investors flocked to the haven of Treasury bonds.

Why were investors so slow to react? It seems they have been consistently blindsided by how widespread the subprime problems have become—as well as complacent about the potential spillover into other areas of the debt markets.

At first, investors thought the subprime issue was confined to a few lenders, but the forthright website www.lenderimplode.com suggests that 97 of them have now been hit. Then they thought that defaults would be confined to a few states in the Midwest but the crisis has spread to heavily populated California and Florida.



The second delay was caused by the way that mortgages had been repackaged and sold. Initially they were bundled into residential mortgage-backed securities or RMBSs; Moody's, a rating agency, downgraded 399 of these bonds, while Standard & Poor's, a rival, indicated it was preparing to downgrade some 612 bonds, worth $12 billion. These bonds are only a small portion of the mortgage-related market. But according to Josh Rosner of the investment firm Graham Fisher, the agencies suggested further downgrades were to come.

The RMBSs are in turn divided up and placed in instruments called collateralised debt obligations or CDOs. These were sold to a wide range of investors, depending on their tolerance for risk. One set of securities, known as an equity tranche, pays the highest returns but is the

first to suffer if the underlying bonds default; other securities offer a much lower yield but a triple-A credit rating, because a lot of defaults would be needed to trigger losses.

The result of this process has, in theory, helped the market. Bank failures have been at the heart of most financial crises. But instead of the banks taking the first hit from mortgage defaults, the pain will be spread round the financial system.

However, nobody knows where the risk now lies. Many of these securities are illiquid, so regular prices are not available. Indeed, highly rated CDO tranches may still be owned by banks that do not have to put a value on these securities. They may not recognise the problem until they are forced to by auditors or by ratings downgrades. On July 11th Moody's said it may cut its ratings on tranches of 91 CDOs worth about $5 billion. “My initial analysis suggests we could see massive cumulative losses into the double-A tranches of many RMBS-backed CDOs,” says Mr Rosner. (Double-A tranches, as their name suggests, are just below triple-A.)

Those required to ascribe a market value to these securities are faced with what ING, an investment bank, describes as a version of the prisoner's dilemma. Everybody would be better off if nobody traded, so that there would be no need to recognise lower prices. But if everybody is planning to sell, those who trade first will have an advantage.

This problem cropped up when two hedge funds run by Bear Stearns, an investment bank, got into trouble in June. The Bear funds had borrowed to enhance returns, and in doing so had to post collateral with lenders, known as prime brokers. When things went wrong, one of the brokers, Merrill Lynch, tried to sell its collateral but soon stopped when it transpired it was only succeeding in driving prices sharply lower. Eventually, Bear Stearns pledged some of its own money to fill the gap.

But prime brokers may also be shrinking the investor pool by increasing the margin that funds must put up when buying CDO assets; according to Matt King of Citigroup, the margin requirement on paper rated at the lowest level of investment grade has risen from 10-20% to 50%. That is bound to discourage some hedge funds.

All this may reduce the pool of potential mortgage investors. This effect may be reinforced by other developments. In recent years, there has been a concerted effort to increase the share of homeowners in America from the post-war average of around 63% to 70%. Lending standards were relaxed and deposits were no longer required. The extreme was reached with so-called *NINJA* loans (borrowers needed no income, job or assets). The influx of new buyers pushed up house prices, which made lenders even more eager.

But as the rating agencies have now discovered, fraud played a part too. Everybody had an incentive to do a deal, almost regardless of the homebuyers' ability to repay; the buyer hoping for a quick profit, the real-estate agent and mortgage broker hoping for a fee. And the banks did not need to be as concerned about creditworthiness as they used to be, given they would be quickly selling the loan.

Now that defaults have shot up, particularly on loans taken out last year, lending standards are being tightened. That will reduce the number of potential buyers and put downward pressure on prices.

Many homeowners are already in trouble. Figures from MacroMavens, an economic consultancy, suggest that 23% of adjustable-rate mortgages, covering loans with a value of $693 billion, are already in negative equity, where the loan is worth more than the property. But the full impact of defaults may not be felt until the low “teaser” rates on mortgages expire and push up borrowing costs. These teaser loans were done on a “two and 28” basis (with low rates applying for the first two years, and higher rates for the next 28). So the worst news from the 2006 vintage may not be felt until 2008.

Nor does default necessarily mean the end of the road. Few lenders want to foreclose, a process that takes ages, incurs massive costs and often causes the departing residents to trash the house. It is better to agree on a quick sale. But too much selling will force prices lower, weakening the rest of the portfolio.

So it may take a while for the property of struggling borrowers to trickle onto the market. Jeffrey Kirsch of American Residential Equities, a company specialising in buying delinquent loans, says foreclosing a property can take more than three years. He doubts the housing market will bottom out until the first quarter of 2009.

The current fear is not so much that the housing market could drive America into recession, although that

could still happen. The worry is more that credit conditions may get tighter. The spread paid by higher-risk European firms has increased by almost a percentage point since mid-June. Investors are shying away from some loans being offered to finance leveraged buy-outs. A slowdown in such private equity-driven bids would hit the stockmarket.

Richard Bernstein, a Merrill Lynch strategist, says excessive lending has been fuelling the growth in financial markets in recent years. But he fears that now liquidity is drying up. That means no cushion when the punch lands.

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Buttonwood

Too much information

Jul 12th 2007
From The Economist print edition

Why investors keep getting it wrong

AT 13.16 British Summer Time on July 11th, traders watching the "All News" page on their Reuters screen would have seen 21 headlines flash up. That would have given them less than three seconds to absorb each item—always assuming, of course, that they had finished reading the 16 stories that appeared at 13.15.

So when one starts to wonder why investors were so slow to wake up to the problems of the subprime mortgage market (see article), information overload has to be a factor. An economist, Fischer Black, described this information as "noise"; investors trade on the back of it even though it has no value. The trouble is that it is very hard to distinguish noise from useful pieces of data.

For example, an extraordinary amount of attention is paid to analysts' forecasts of company profits. But a study by James Montier and Rui Antunes of Dresdner Kleinwort, an investment bank, found that the average forecasting error on such predictions was 43% over 12 months and 95% over two years.

The markets now resemble those nesting chicks that chirrup constantly for their parents to feed them. They gorge on a daily diet of supposedly important economic data. Most of the statistics are revised in subsequent weeks but the revisions rarely have as much market impact as the original figures.

More information does not necessarily lead to better decisions. Michael Mauboussin of Legg Mason, a fund-management group, cites a study that gave horse-racing handicappers varying amounts of information when ranking horses. The more information they received, the more confident they became about their answers. But the success of their predictions was actually worse when given 40 pieces of information, than when given five.

This creates some interesting possibilities. As Richard Oldfield, a fund manager, suggests in his new book*, "price movements in response to news are exaggerated, providing an opportunity to those who do not base too much on what has happened in the last hour or 24 hours."

But breaking away from the herd is very difficult, not least because it is hard to tell what the herd is actually thinking. Banks and brokers produce sentiment indicators but, on some occasions, the different benchmarks may suggest investors are simultaneously euphoric and risk-averse. A day watching CNBC, a financial television channel, or a few minutes trawling the internet should allow investors to come across every shade of opinion from perma-bear to super-bull.

In any case, we are all contrarians now. The growth of the derivatives markets has made it a lot easier to bet on falling, as well as rising, prices. For every hedge fund that has lost a bundle in the subprime market, there may be two or three that have already earned their annual performance fee from betting the right way.

In the face of this torrent of information, it is perhaps unsurprising that investors rely on whom they know, rather than what they know. An academic study† has found that American mutual-fund managers are more likely to weigh their portfolios in favour of shares in companies in which one of the senior officers went to the same university as they did. The effect is strongest when they were there at the same time and on the same course.

This example of the "old school tie" in action is remarkably effective. The stocks chosen in this way outperform unconnected stocks by 8.4 percentage points a year. Perhaps sharing a dorm with a future executive tells you something about his or her character.

This is only the latest in a series of market anomalies that have been discovered over the years. One of

the most striking undermines the capital-asset pricing model, the basis for academic analysis of the markets. In the model, stocks that are more volatile ("high beta" in the jargon) produce higher returns than more stable ("low beta") securities. But a study by Jeremy Grantham of GMO, a fund-management firm, found that, over the period from 1963 to 2006, the supposedly boring low-beta stocks beat the racier high-beta ones by as much as four percentage points a year.

All this confirms what most investors who lived through the dotcom bubble must feel: investors are not always rational and markets are not always efficient. But, judging by the subprime saga, spotting those irrational moments is no easier than it ever was.

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*"Simple But Not Easy", by Richard Oldfield, Doddington Publishing.

†"The Small World of Investing: Board Connections and Mutual Fund Returns", by Lauren Cohen, Andrea Frazzini and Christopher Malloy, National Bureau of Economic Research, working paper 13121.

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Debt ratings

AAAsking for trouble

Jul 12th 2007
From The Economist print edition

Not all triple-A ratings inspire total confidence

IN THE depression-era 1930s, when credit worthiness was all that mattered, American government bonds were rated AAAAA—as if the more letters you attached to a borrower, the safer they would seem. In more recent times, the triple-A designation has done the trick. Whether attached to government debt, federal agencies or the strongest corporate borrowers, it has stood as a gold standard among ratings, lowering borrowing costs and reassuring creditors.

During the 1980s and 1990s, scarcity only enhanced its standing. The number of companies issuing such high-grade debt dwindled, as corporate-finance theory encouraged companies to borrow more heavily to increase earnings. According to Standard & Poor's (S&P), a rating agency, only six American non-bank companies carry a triple-A rating today, including Berkshire Hathaway and General Electric.

But the rating is coming in for some stick from politicians and pundits alike, because it has cropped up in connection with that most unsound of loans, subprime mortgages. These are anything but triple-A, but can be repackaged into securities via collateralised debt obligations (CDOs) in a way that makes default an extremely low mathematical probability. In the process, such ratings have made the agencies a great deal of money. Moody's, for example, made more than 40% of its revenues from rating structured products such as CDOs last year.

Marc Dann, attorney-general of Ohio, is investigating whether, in his words, the ratings agencies took part in fraud by bestowing triple-A ratings on structured products created out of subprime loans. Bill Gross, a fund manager at PIMCO, a bond-trading firm, likens the highest-rated tranches of CDOs to a Hollywood madame masquerading as a wholesome, all-American girl.

The ratings agencies are holding their ground. Cliff Griep, the chief credit officer at S&P, argues that ratings attempt to address only creditworthiness, not market risk, and are driven by fundamentals, not fluctuating prices.

But the questions being asked of the agencies are important because banks around the world have been filling their vaults with AAA-rated structured products ahead of international implementation of the Basel 2 regulations on bank capital. Under this new accord, a bank holding triple-A assets is allowed to keep less capital, enabling it to lend more. So banks have stocked up, especially on CDOs. If they were forced to sell securities that had been downgraded, liquidity could dry up.

No one knows for sure what would happen to the value of the triple-A tranches in such a scenario. In this week's ratings downgrades, the highest-quality tranches of CDOs were unaffected.

But the agencies are caught in a dilemma. They know that if the cherished triple-A rating is seen as devalued, it would undermine their credibility. Yet they earn so much revenue from CDOs that working with the banks and funds that structure them has proved irresistible.

Some analysts argue that it would make sense to alter the labelling. John Mauldin, who writes a popular financial newsletter, argues that the ratings agencies should have created a new type of standard, using numbers like “CDO rank 1-10”. That way a triple-A mark would still stand for a port in a storm.

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Investment banking

Down the Matterhorn

Jul 12th 2007 | ZURICH AND NEW YORK
From The Economist print edition

UBS falls from grace

ROGER FEDERER has won again at Wimbledon and the Swiss yacht Alinghi retained the Americas Cup. But another Swiss phenomenon, UBS, a global bank, has lost its footing during a bold ascent of the investment-banking industry.

That is the jarring message that has emerged this week after the abrupt dismissal of its chief executive, Peter Wuffli, announced on July 5th. The unexpected sacrifice has drawn attention to the problems facing Marcel Ospel, the chairman, as he deals with an investment bank that has failed in its efforts to become, in robotic Swiss bankers' speak, “best in class”.

Keystone

The gospel according to Ospel

UBS has a global investment bank and is the world's biggest manager of other people's money. Until a year ago its mixture of financial expertise and prudent risk management seemed to be a winning formula. But a few glaring mistakes, and late entry into markets where its peers have been raking in money, have left its costs and earnings out of kilter.

The problems are especially acute in the fixed-income department of the investment bank, where debt products are issued and traded. But it has also had trouble attracting and keeping top people.

Partly to address that, it took what now looks like a disastrous punt (though other investment banks have done likewise) in creating a hedge-fund venture in 2005 run by John Costas, the former head of investment banking. The operation, which invested in American mortgages, was shut down in May at a cost of at least $425m.

In another debacle, Ken Moelis, a top corporate financier, left the bank in March complaining about its lacklustre lending ambitions. Later he forced UBS to split fees on a big advisory deal, the sale of Hilton Hotels to Blackstone, a private-equity firm. UBS's street credibility (at least among the Wall Street crowd where Mr Moelis works) was badly damaged, and staff loyalty started to suffer.

UBS has also missed out, according to rivals, on much of the frothy business, such as structured products and leveraged finance, which has earned investment banks record profits in recent years. That could be attributed to justifiable risk aversion—after all UBS's pedigree is as a Swiss private bank, protector of people's capital. But not in Mr Ospel's eyes.

Ostensibly, that is why Mr Wuffli was replaced by Marcel Rohner, the new boss, though it is not clear whether the 42-year-old former private banker and risk manager has the hard edge to cut it in investment banking. For that, the responsibility is likely to fall more to Mr Ospel, who led the bank through its most expansive years and who has now acceded to board pressure to stay as chairman until 2011.

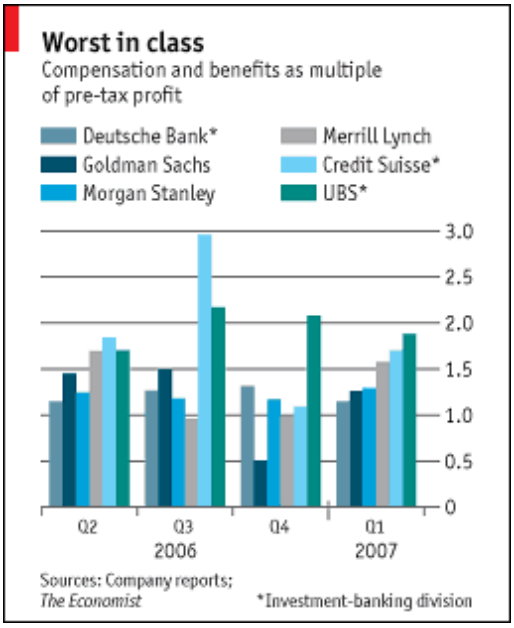
Mr Ospel is a seasoned risk-taker. But he will be under immediate pressure to boost profits. Of its peers, UBS has the worst record when it comes to measuring what it pays its bankers against investment-banking profits (see chart). Its rival, Credit Suisse, had some bad quarters, but its performance was better in the last year than UBS's, against whom it used often to fall short.

Both Swiss banks have still to prove the worth of their “one-bank strategy”, which involves gathering investment banking, private banking and asset management under one roof. Both contend that

it works: rich individuals, such as owners of family firms or Asian entrepreneurs, buy investment-banking products, they say. UBS reckons such cross-selling brings in revenues of close to SFr3 billion ($2.5 billion) a year. It also makes the banks more diversified than rivals such as Goldman Sachs and Morgan Stanley.

But not everyone is convinced. Analysts tend to value asset management at higher earnings multiples than investment banking, meaning that the latter might be depressing UBS's overall share price—especially if it is misfiring.

The risk for UBS is that it may stick its neck out at exactly the wrong time in the credit cycle. It may not be long before Mr Wuffli's cautious strategy about debt may start looking prescient.



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South Korea's financial markets

Do as I say, not as I do

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From The Economist print edition

Strange ways to make a big bang

Get article background

FOR those South Koreans who want to transform their sometimes insular country into an Asian financial hub, July 3rd was a momentous day. South Korea passed its own version of Britain's "big bang", the 1986 deregulation that enabled London to become a global financial centre. In South Korea the legislation will remove bureaucratic barriers in its securities industry and help brokers, banks and possibly insurers to consolidate.

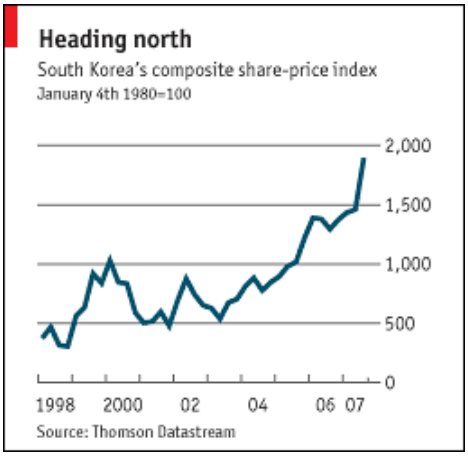
For those foreign bankers who wonder why anyone bothers to get off a plane in Seoul, a decision by a tax appeals court on July 5th sent just the opposite message. Lone Star Funds, a Texas-based buy-out firm, lost an appeal on a $110m assessment stemming from the lucrative sale of an office block held in what had been thought to be a tax-exempt subsidiary. The ruling refocused attention on what, for both Lone Star and South Korea, has been a public-relations disaster.

Back in 2003, when South Korea was stuck in a protracted slump, Lone Star was something of a hero. It came in when other investors would not and made investments that included taking control of a big bank. It seemed a shrewd bet. In the subsequent recovery, the returns were spectacular—too much so for some South Koreans, who believe that Lone Star got too sweet a deal. Well-publicised prosecutions followed a public outcry. Lone Star is now involved in two big trials and a number of smaller actions, all suggesting it manipulated figures in order to buy companies on the cheap or to avoid paying taxes. It is fighting the charges.

Lengthy lawsuits are not the only factors discouraging investment in South Korea. Foreign-exchange controls make it hard to repatriate profits. The local currency, the won, is not much use in global markets. Regulatory filings must be done in Korean. No foreign company has so far listed on Seoul's stock exchange. Legal barriers limit, or exclude, foreign law firms and accountants. Foreign hedge funds and private-equity firms have, with few exceptions, passed judgment with their feet and stayed away.

Most of the big financial institutions are present, but labour negotiations can be so wretched that many bankers consider the country toxic. Even lenient banks are not let off. Standard Chartered is viewed by competitors as a particularly accommodating employer in South Korea. But a union has festooned the lobby of its Seoul headquarters with hostile billboards.

And yet South Korea's good intentions should not be written off. Its advocates start by spreading a map. The country lies between Japan and China and has a good airport. Its people are well educated; many study abroad. Communications are excellent. In just a few years, Seoul has lost its gritty-city image and the country's television shows, movies and fashion have become hits throughout Asia. For an expatriate banker, it need not be a backwater. South Korea's stockmarket is hitting records (see chart), its banks are healthy, foreign-exchange reserves are strong and savings are growing.



More importantly, attitudes are improving. Restrictions on foreign lawyers and accountants are being relaxed; a free-trade agreement has been struck with America. A non-American banker says he was stunned to read the fine print of the deal and to see how much it helped his own business. At the moment, South Korea's financial ambitions seem quixotic, but no Asian market can boast of superlative disclosure and transparency. An opportunity exists for any country that gets it right.

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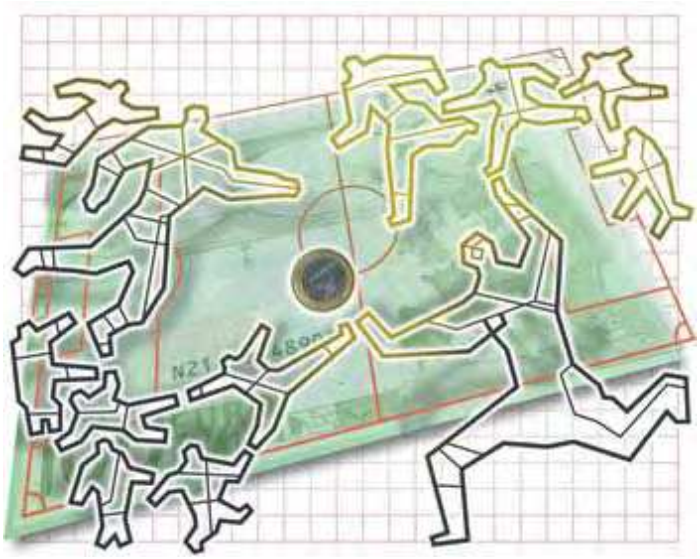
Economics focus

Sporting chance

Jul 12th 2007
From The Economist print edition

JAC



A block exemption from antitrust law is a bad idea for European football

GEORGE ORWELL was not too keen on sport. “It is bound up with hatred, jealousy, boastfulness, disregard of all rules and sadistic pleasure in witnessing violence,” he wrote: “In other words it is war minus the shooting.” Only a very brave or foolhardy politician would echo Orwell's sentiments. Professional sport is too popular for governments to be anything other than supporters of it. An article in the European Union treaty agreed at Nice in 2000 proclaimed sport as a “specificity”, whose social and cultural significance warranted special treatment.

Yet sport in Europe is also a business and, in the case of football, a lucrative one. The tension between its commercial role and cultural status creates a difficulty for economic policymakers. Is sport just like any other competitive enterprise or should it be handled differently?

Champions in league

Sport is different in one important respect. Unlike most other businesses, in sport competitors need to collude to provide a sellable product. The creation of a sporting spectacle requires teams to co-ordinate times and venues for matches and to agree on the rules of competition. For most businesses, competitors are a constraint on their commercial activities, but sports teams have a peculiar interest in the viability of rivals. This collaborative element requires careful treatment by antitrust regulators. Collective selling of television rights, for instance, can be defended on the grounds that the contest itself is the product on offer.

Joint selling also helps ensure that revenues are doled out fairly. Television money has overtaken matchday ticket sales as the most important source of income in football. Individual bargaining might leave poorly supported teams with too little revenue, which over time could destroy the competitive balance of leagues, to the detriment of consumers and teams alike. Competitive success in sport mostly comes down to resources. Teams that can pay for the best players and coaches will be the most consistent winners. Without some measure of income sharing, league competition might become a dull and predictable cakewalk for the best-supported team.

The authorities have to walk a fine line. In the early 1990s, the deregulation of television broadcasting brought huge sums of money into sport, and football started to attract the attention of competition

authorities and courts over its restrictive business practices. A 1995 legal challenge by Jean-Marc Bosman, a Belgian player, ended the practice of charging a transfer fee for a player's registration once his contract had expired. The Bosman ruling also illustrated that quotas for “foreign” players were incompatible with EU law. The selling of broadcast rights for football matches in England and Germany has been investigated by trustbusters concerned that consumers might be scalped or deprived of choice.

In practice, Europe's competition authorities have authorised the collective selling deals that have been referred to them. This is not, however, a case of special treatment for sport. Co-ordination between rival firms usually falls foul of antitrust watchdogs, but is sanctioned if it serves consumers. For instance, joint ventures between rival airlines are permitted if trustbusters judge that the benefits of passenger convenience outweigh the harm to price competition. Block exemptions from EU antitrust law permit firms to pool research and development (R&D) spending and to license proprietary technologies to rivals. There are blanket exemptions too for transport agreements that allow airlines and shipping companies to co-ordinate schedules.

Some influential voices would like the same sort of block exemption for European sport. The Independent European Sport Review, launched last year by several EU sports ministers, declared that “football should not be a contest between corporate leviathans with the outcome dictated by whoever has the deepest pockets.” It advocated greater revenue sharing, wage-bill caps and restrictions on player transfers, and suggested block exemptions as a way of reconciling these measures with EU competition law. The report was warmly endorsed by UEFA, European football's governing body.

But unless policymakers can say for sure that block exemptions would help consumers, they are best to stick with a case-by-case analysis. Exemptions from antitrust laws are fine if unchecked rivalry would lead to flawed outcomes. Fewer drugs would be made if pharmaceutical companies were not allowed to license each other's patents. R&D alliances ensure that the costs of research are shared between the companies that profit from it, which supplies an incentive for innovation that might be otherwise absent. It is not clear, however, that consumers would be better off if sport had its own blanket exemption.

A lot rests on the idea that stricter competitive balance is vital to the long-term viability of professional sports. Stefan Szymanski, a professor at London's Imperial College who has written several books on the economics of football, suspects that the case for income parity is a little shaky. Professional soccer in Europe has always been unbalanced, he says, but this has not obviously diminished its popularity. The pyramid structure of leagues, with promotion and relegation, keeps interest alive for teams that have little chance of winning championships. In the top leagues of each country, a high finish qualifies a team for one of the pan-European competitions—the Champions League and the UEFA Cup—that run in parallel with national contests. Local rivalries and the chance for underdogs to embarrass their superiors provide other avenues of interest for soccer fans, who may value excellence more highly than competitive balance. Indeed games between well-matched soccer teams are often cautious, tactical affairs that make for dull viewing. In other words, war minus the shooting. And who would want that?

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Computing and biology

Arresting developments

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Computer science and biological science have a lot to teach each other

Stephen Jeffrey

THERE is, at the moment, a lot of interest in the idea of artificial life. The ability to synthesise huge screeds of DNA at will means the genomes of viruses can be replicated already, and replicating those of bacteria is not far off. But that merely copies what nature already manages routinely. David Harel of the Weizmann Institute in Israel reckons he can do better. He proposes to recreate living organisms inside a computer.

As with many biologists, his creature of choice is a worm called *Caenorhabditis elegans*. This tiny nematode (it is just a millimetre long) was the first organism to have its developmental pathway worked out cell by cell and the first multicellular one to have its genome sequenced completely. It is probably, therefore, the best understood animal in biology.

As he told “The next 10 years”, a conference organised by Microsoft Research in Cambridge, England, Dr Harel has been working on a computer model of *C. elegans*. He hopes this will reveal exactly how pluripotent stem cells—those capable of becoming any sort of mature cell—decide which speciality they will take on. He thinks that a true understanding of the processes involved will be demonstrated only when it is possible to build a simulation that does exactly—but artificially—what happens in nature. With colleagues at New York University and Yale University in America, he is modelling and testing the possibilities.

Indeed, he proposes to evaluate the result using an updated version of the Turing test. This was devised by Alan Turing, an early computer scientist, to identify whether a machine is capable of thought. The original test proposes that a person be presented with a suitable interface—say, a keyboard and a screen—through which to communicate. If the operator cannot tell the difference between talking to another person through this interface and talking to a computer, then the computer can be argued to be thinking. Dr Harel's version is a little more challenging. He wants to test whether scientists well versed in the ways of *C. elegans* could tell his computerised version from the real thing. So far, the distinction is obvious, but it may not always remain so.

Silicon biology

Stephen Emmott, who works for Microsoft Research, wonders whether to turn the whole approach on its head. Instead of looking at how computers can mimic creatures, he wants to build computers from biological components. People—and other creatures—are notoriously forgetful and not much good at number crunching compared with their silicon counterparts. But they do have compensating advantages. People excel at reasoning and make much better learning machines than do computers. Dr Emmott reckons that a biological computer might find it easier to cope with problems that have foxed the traditional, silicon variety for decades—such as how to recognise what it is that they see.

Working with Stephen Muggleton of Imperial College, London, he is developing an “artificial scientist” that would be capable of combining inductive logic with probabilistic reasoning. Such a computer would be able to design experiments, collect the results and then integrate those results with theory. Indeed, it should be possible, the pair think, for the artificial scientist to build hypotheses directly from the data, spotting relationships that the humble graduate student or even his supervisor might miss.

Indeed, Luca Cardelli, who also works for Microsoft Research, likens biological cells to computers. He points out that creatures are programmed to find food and to avoid predators. But exactly how the “wetware” of molecular biology works remains a mystery. Dr Cardelli is trying to discover whether it is more like the hardware of electronic circuits or the software of programming languages. He is using statistical techniques—in particular, a method called stochastic pi-calculus—to model how biological systems appear to change with time.

His colleagues, meanwhile, are examining how the spread of diseases such as malaria and AIDS can be thought of as information systems. They are using what used to be called artificial intelligence and is now referred to as machine learning to explore the relationships between the two. All of which raises some interesting philosophical points. If, say, a computer were used to diagnose a patient's symptoms and recommend treatment, and the result was flawed, could the computer be held responsible? Peter Lipton of the University of Cambridge, who ponders such matters, suggests that such expert systems could indeed be held morally responsible for the consequences of their actions (although the designers of such systems would not necessarily be off the hook). If so, then it is hard to see why computers should not be recognised for good work as well. If Dr Lipton is correct, the race has now begun to see whether the first artificial scientist to win a Nobel prize is based on silicon or biological material.

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Ageing

The long and the short of it

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Children may inherit their lifespans from their fathers, not their mothers

BIOLOGISTS have long been befuddled by the causes of ageing. The underlying principle is known as the disposable soma. This is the idea that a hen is merely an egg's way of making another egg. Given that the hen is likely, sooner or later, to meet a hungry fox, there is little point in it having a body which can repair itself perfectly—particularly if the resources for that repair come at the expense of egg-laying. Hence that body (or soma, in Greek) gradually runs down. How this general principle plays out in particular, though, is the subject of eager study.

Wen-Chi Hsueh of the University of California, San Francisco, has been looking at one important aspect of disposable-soma theory. This is the role of structures called telomeres that cap the ends of chromosomes. Every time a cell divides, its telomeres get shorter. When they shrink beyond a certain point, that cell can no longer divide. The reason for this is believed to be to stop cancer in its tracks by preventing tumour cells from dividing more than a certain number of times. (Successful cancers often have a special enzyme that repairs telomeres.) The cost is that, eventually, even healthy tissue cannot renew itself. So the longer your telomeres are, the longer you can expect to live. But what remains unknown is why some people have longer telomeres than others. And it is this question that Dr Hsueh addresses in a paper just published in the *Proceedings of the National Academy of Sciences*.

Old Order Amish—the most traditional of the Pennsylvania Dutch communities—are unusual in many ways. They eat the same food together, farm that food together and do not marry outsiders. They do not smoke, drink or drive. And, almost uniquely, their menfolk have the same average lifespan as their women—71 years. For that last reason, and also because the Amish have come to welcome medical researchers who wish to study them for the edification of less well-disciplined examples of humanity, Dr Hsueh focused her endeavours in Lancaster county, Pennsylvania, where the Amish live.

She and her colleagues asked volunteers to give blood samples. They then extracted DNA from cells in those samples and measured the average length of the 356 male volunteers' and 551 female volunteers' telomeres. Next to that number, they recorded the volunteers' ages.

Their first observation was that, adjusted for age, the telomeres of men and women were the same length. (In the outside world, men generally have shorter telomeres than their female contemporaries.) That correlates nicely with the fact that among the Amish, men and women are equally long lived. And, since it is unlikely (though not impossible) that Amish men are genetically different from others, it also suggests that men's shorter telomeres in the outside world are a result of the way they conduct their lives, rather than an inevitable property of being male.

Of course, a healthy way of life is well known to prolong existence. But it is also true, as every actuary knows, that the best way to live for a long time is to pick your parents carefully. Long-lived parents tend to have long-lived offspring. With that in mind, the researchers started comparing telomere lengths within families.

Tel-tales

What they found was a bit of a shock. Children's telomeres did, indeed, correlate in length with those of their parents—but they correlated only with one parent, the father. Moreover, it was not merely the father's telomere length that correlated with that of his offspring, but also his actual lifespan. But here, too, there was a sex-linked wrinkle. The correlation between paternal lifespan and children's telomere length applied only to daughters. Moreover, the age at which men and women became parents also influenced their offspring's average telomere length: the older the parents, the longer the offspring's telomeres.

There is, frankly, no good explanation for these results at the moment. Dr Hsueh suggests that part of the answer may lie in a conflict between maternal and paternal genes. Such conflicts have been observed in the womb, when genes derived from the two parents compete to control the amount of nutrition a fetus draws from its mother. It is hard, though, to see a parent's evolutionary interest in controlling its offspring's lifespan by making some somas more disposable than others—nor why evolution would favour longevity in the children of older parents. Biologists, therefore, are still befuddled. But actuaries might care to take note.

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Sexual selection and Chernobyl

Plumes and plumage

Jul 12th 2007
From The Economist print edition

How an industrial accident has helped evolutionary theory

SOMETIMES, scientific results come from the most unlikely places. The aftermath of the Chernobyl nuclear accident, for example, might reasonably be expected to have revealed the effects of radiation on health. That it casts light on the theory of sexual selection as well is a bit of a surprise.

That, nevertheless, is the inference of a paper by Anders Moller of Pierre & Marie Curie University in Paris, and Timothy Mousseau of the University of South Carolina. Dr Moller and Dr Mousseau have been looking at bird life around the wrecked reactor. One of their conclusions, just published in the *Journal of Applied Ecology*, is that colourful species have done less well than dull ones. Since colourful plumage is almost always a sexual signal, understanding why is instructive.

The data come from a census of 57 bird species that the researchers carried out in the area affected by the radioactive plume from the accident. When due allowance was made for habitat differences, they found that species which relied on a class of chemicals called carotenoids to tint their feathers fared worse when there was more radioactivity around. Intriguingly, that did not apply to birds that used melanin, another pigment, in their plumage, nor to those that employed iridescence—which is a result of the structure of feathers, rather than their chemistry.

Besides acting as pigments, carotenoids are antioxidants that have an important role in protecting DNA from harm. One of the ways that radiation causes harm is by generating molecules that promote oxidation, so a good supply of carotenoids protects against such damage. Using them to make feathers pretty instead of mopping up oxidative molecules thus has a significant cost—as this result shows.

The reason this is interesting is that there is a debate in biology between those who think signals such as flashy feathers are essentially arbitrary and those who think they are signs of underlying health and good genes. Dr Moller's and Dr Mousseau's result shows that the bright reds and yellows of carotenoid-based plumage really do come at a price, and thus indicate underlying health. The unusual circumstances of Chernobyl have exposed that price to human observers, but it will have to be paid all the time, even in places that have not fallen foul of radioactive plumes.

The costs of melanin-based plumage and iridescence are clearly different from this. No doubt they exist, but it would be nice to think that the experiment needed to expose them is not quite so drastic as an exploding reactor.

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Biological pest control

Ant and tech

Jul 12th 2007
From The Economist print edition

How weaver ants could come to the rescue of African mango farmers

THE humble but industrious ant has long served as a metaphor for the economic virtues of simplicity, parsimony and diligence. But in the case of weaver ants in Africa, this description may be more than just a metaphor. According to a study published in the latest issue of the *Journal of Economic Entomology*, by Paul van Mele of the Consultative Group on International Agricultural Research and his colleagues, African mango farmers could increase their harvests by as much as two-thirds with the help of these doughty insects.

Mangoes in Africa, as elsewhere, often fall prey to fruit flies, which destroy about 40% of the continent's crop. In fact, fruit flies are so common in African mangoes that America has banned their import altogether, to protect its own orchards. African farmers, meanwhile, have few practical means to defend their fruit. Chemical pesticides are expensive. And even for those who can afford them they are not that effective since, by the time a farmer spots an infestation, it is too late to spray. Added to that, spraying tall trees is a much more complicated and unhealthy business than treating low-growing fruit and vegetables.

Agricultural scientists have also looked at controlling fruit flies with parasitic wasps. But the most common ones kill off only about one fly in 20, leaving plenty of survivors to go on the rampage. Lethal traps baited with fly-attracting pheromones are another option. But they, too, are expensive. Moreover, all these methods require farmers to detect the presence of fruit flies, and to identify them as the main threat to their crop—no mean feat when most of the action is taking place in dense, leafy canopies ten metres off the ground. Instead, most farmers simply harvest their fruit early, when it is not yet fully ripe. This makes it less vulnerable to the flies, but also less valuable.

Farmers whose trees are teeming with weaver ants, however, do not need to bother with any of this. In a survey of several orchards in Benin, Dr van Mele and his colleagues found an average of less than one fruit-fly pupa in each batch of 30 mangoes from trees where weaver ants were abundant, but an average of 77 pupae in batches from trees without weaver ants. The weaver ants, it turns out, are very thorough about hunting down and eating fruit flies, as well as a host of other pests. The only drawback is the ants' painful bite, which can be avoided by harvesting fruit with poles, rather than climbing trees.

Weaver ants have been used for pest control in China and other Asian countries for centuries. The practice has also been adopted in Australia. But Dr van Mele argues that it is particularly suited to Africa since weaver ants are endemic to the mango-growing regions of the continent, and little training or capital is needed to put them to work. All you need do is locate a suitable nest and run string from it to the trees you wish to protect. The ants will then quickly find their way to the target. Teaching a group of farmers in Burkina Faso to use weaver ants in this way took just a day, according to Dr van Mele. Those farmers no longer use pesticides to control fruit flies, and so are able to market their mangoes as organic to eager European consumers, vastly increasing their income. The ants, so to speak, are on the march.

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History of science

Revolutionaries at work and play

Jul 12th 2007
From The Economist print edition

The giant brains who devised quantum mechanics, whatever that means

Faust in Copenhagen: A Struggle for the Soul of Physics
By Gino Segrè

Viking; 320 pages; $25.95.
Jonathan Cape; £20

Buy it at
Amazon.com
Amazon.co.uk

Uncertainty: Einstein, Heisenberg, Bohr, and the Struggle for the Soul of Science
By David Lindley

Doubleday; 257 pages; $26

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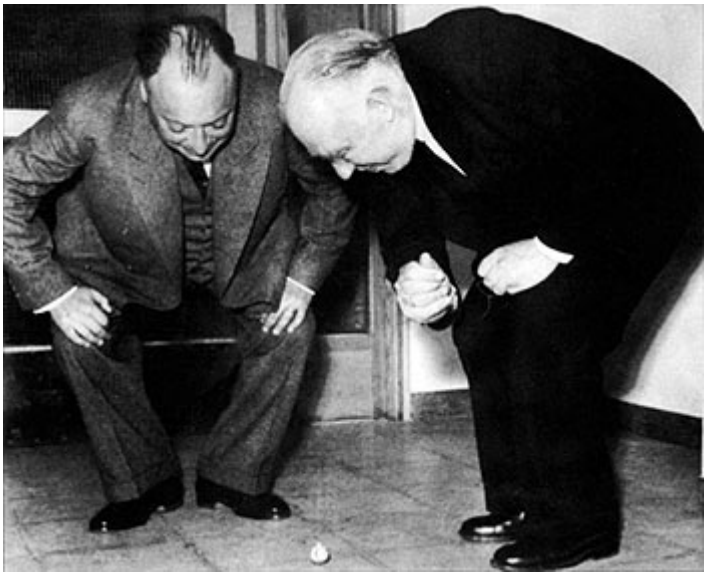

PHYSICS was revolutionised by quantum mechanics almost a century ago. The bizarre consequences include the fundamental truth that it is impossible to know everything about the world; the meaning of quantum mechanics still provokes head-scratching by physicists and philosophers alike. A portrait of the great personalities who drove the revolution is provided by these two books.

Perhaps because the subject was mathematically complex and ran counter to classical notions of physical laws, the community of physicists who developed it was small and overwhelmingly young.

In “Faust in Copenhagen” Gino Segrè identifies seven people who devised quantum mechanics: six men and a woman. Five of them went on to become Nobel laureates, and the city in which they did much of their work has become synonymous with the dominant philosophical understanding of the subject. The “Copenhagen interpretation” says that the world people experience is decided upon when the many possibilities of the quantum world collapse to become the certainty of the classical one. (A rival to this view is that the many possibilities of the quantum world all continue to be real and that there are thus many worlds.)

The book takes as its organising theme a short comedy written and performed by the more mischievous members of this community as entertainment at the end of an informal academic gathering held in April 1932. The sketch was based on Goethe's “Faust” where the hero, famously frustrated by the limits to his learning, makes a pact with the devil.

Unlike the other revolution in 20th-century physics, Einstein's general theory of relativity, which emerged from the mind of a single man, quantum mechanics was a group effort. Indeed, it could be argued that it is the more profound achievement and could not have emerged from a single mind. Each person developing it needed the others to help explain what it was they had achieved. But the personalities were hugely different from one another.

Niels Bohr, the elder statesman of the community, was an athletic team worker and family man who needed constant companionship to test his thoughts. He played God in the comedy and is seen above, on the right, studying a spinning top with Wolfgang Pauli. Pauli (who had the part of Mephistopheles) was a portly womaniser given to drinking and smoking; his razor-sharp wit was both scathing and hilarious. Paul Dirac would today be diagnosed with a personality disorder: he could not grasp anything other than the direct logic of the spoken word. Werner Heisenberg was intensely competitive and a tacit supporter of Nazi Germany.

Mr Segrè's tome is a mostly engaging tale: well-researched and fully aware of the political backdrop. He remains true to the scientific language and thought of the time, not resorting to modern concepts. But despite a warning that “there is a good deal of science in the book, as much as can be accommodated without the machinery of equations”, the story neglects the physics. It misses the opportunity to give some appreciation of the beauty of quantum mechanics—and to explain exactly where the subject becomes so confounding.

By contrast David Lindley's volume puts a more equal weight on the science and the personalities who devised it. The book is charmingly written and a delight to read. It has, however, the wrong title: “Uncertainty” is but a single part of quantum mechanics and Mr Lindley covers far more ground, taking

readers through a history of atomic and nuclear physics. This enables him to include Einstein who, despite receiving his Nobel prize for early work on quantum mechanics, devoted much of his efforts to opposing the Copenhagen interpretation of it.

Both books highlight the human element of science. Although a Nobel prize is awarded to no more than three individuals, fundamental physics is often done as teamwork. Biographies that capture not only the people involved but also how they interact are a welcome antidote to the impression that the best science is done by the genius alone in his garret.

Faust in Copenhagen: A Struggle for the Soul of Physics.
By Gino Segrè.
Viking; 320 pages; $25.95.
Jonathan Cape; £20

Uncertainty: Einstein, Heisenberg, Bohr, and the Struggle for the Soul of Science.
By David Lindley.
Doubleday; 257 pages; $26

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Corporate strategy

Be firm, be flexible

Jul 12th 2007
From The Economist print edition

STRATEGY lies on the high ground of business management, the zone where long-term plans are made and far-sighted visionaries set their companies on course to untold riches. Books on the subject establish their authors' intellectual reputation, for strategy is full of paradoxes and dilemmas that challenge the brain to find seven simple steps to their resolution.

Michael Raynor claims that great strategies lead either to huge success or to huge failure. He illustrates this paradox with the rather overused example of Sony's Betamax video system and its MiniDisc, products which, he says, “had all the elements of success, but neither succeeded”. So why did they flop while Sony's Walkman and its development of the CD were such big hits? “The main factor separating success and failure”, claims Mr Raynor, “is...luck.”

Those tempted to read on and discover how to defeat fate (“although the future is uncertain, your fate does not have to be”) will be rewarded along the way with some entertaining asides. There is, for example, a description of the influence of the pornographic film industry on technical video formats. Then there is a discussion of the work of Elliott Jaques, a Canadian psychologist who examined the different time horizons of people at different levels of the corporate hierarchy. The strategic thinker at the top has to look years ahead, while the salesman on the road can rarely take his eyes off this month's target.

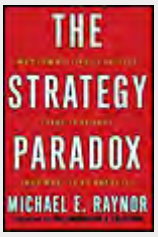
Chris Zook takes the reader on a jolly journey round a number of cases where companies have made themselves “unstoppable” by exploiting “hidden assets”. His examples are far fresher than Mr Raynor's, ranging from the case of De Beers, which discovered that it need not only be a flogger of carbon chips when it was also the “custodian of the diamond dream”, to that of Marvel Entertainment which asked itself, just in time, why be a publisher of unpopular comic books when you are the owner of enormously popular characters such as Spider-Man? Like Mr Raynor, Mr Zook has interesting asides—on, for example, “the curse of the distant follower”, the slim chance companies have of overtaking market leaders once they fall way behind.

The two books serve to emphasise the extent to which corporate strategy is man's territory. Like golf, religion and the working breakfast, it seems set on excluding women from decision-making. Mr Zook's bibliography lists 55 books written by men and one by a woman. Mr Raynor's reference index contains the names of 80 men and not a single woman. Strategy today still assumes that corporate decision-makers are like generals on a battlefield, fighting in a sequential world where one step is “then” followed by another along a route clearly marked “either/or”. In reality, though, strategy is now a world more familiar to working mothers, where the inhabitants juggle many issues at once and rarely face clear-cut either/or situations.

The books also show how bereft of inspiration corporate strategy is these days. Mr Zook's book is the third in a trilogy which started off with some good ideas about how companies can squeeze their core businesses for all they are worth. It has ended with advice to grope around (systematically, of course) in the corporate attic with the hope of stumbling across hidden goodies that have so far been unappreciated. Mr Raynor sets out to show us how to create our own good luck, no less. “Only by understanding the strategy paradox's root cause”, he says, “can we build strategies that succeed deliberately, rather than only when fortune smiles upon us.”

Much of the discussion about strategy today revolves around an age-old dilemma (yes indeed, for such it

The Strategy Paradox: Why Committing to Success Leads to Failure (and What to Do About It)
By Michael E. Raynor



Currency; 303 pages; $27.50

Buy it at
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Unstoppable: Finding Hidden Assets to Renew the Core and Fuel Profitable Growth
By Chris Zook

Harvard Business School Press; 208 pages; $29.95

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is) between firmness and flexibility. In so far as strategy implies unchanging commitment, it is the antithesis of flexibility. Yet in today's fast-changing world, firms want to keep as many strategic options open for as long as possible. Technology is helping them to do this, but is it at the expense of old-fashioned steadfastness? Much of Yahoo!'s recent trouble, for example, was attributed by one of its senior executives to the company being “reactive instead of charting an unwavering course”.

Maybe what companies need is a book to teach them how to be both firm and flexible at the same time. A book perhaps with the female touch?

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The German economy

A gloomster's lament

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From The Economist print edition

THERE is something rather annoying about the German economy. It is the object of endless lectures about taxes and wages that are too high, welfare and pension benefits that are too generous, east German states that have become subsidy junkies and a labour market that is irredeemably sclerotic. Yet it always bounces back. Just now exports and profits are at record highs, unemployment is falling fast and annual GDP growth has picked up to almost 3%. It is, in short, a place that seems to work in practice but not in theory.

Liberals like Hans-Werner Sinn, who runs the CESifo institute at the University of Munich, are unconvinced. For two decades he has been one of the loudest voices preaching the urgency of structural reform (another is Horst Siebert at Kiel University, who argued a similar case two years ago in "The German Economy: Beyond the Social Market", published by Princeton University Press). Mr Sinn's new work is a thoroughly updated English-language version of a German book that has gone through no fewer than 11 editions. Not for nothing is *Angst* a German word.

Can Germany Be Saved?: The Malaise of the World's First Welfare State
By Hans-Werner Sinn

MIT Press; 338 pages; $29.95 and £18.95

Buy it at
Amazon.com
Amazon.co.uk

It is hard to argue with most of the author's conclusions. Even with its present revival, German GDP growth remains low by historical standards. There is little chance of further supply-side reforms under Angela Merkel's consensus-driven grand coalition. The coddled, low-productivity east is an expensive drag on the innovative, high-productivity west. And much of the rise in profits and exports reflects a ferocious one-off squeeze on real wages that has allowed German companies to steal a march on less efficient competitors in France and Italy, but this is not a process that is indefinitely sustainable without far more liberalisation.

The case for more reform, especially to the labour market and welfare state, is unanswerable. But Mr Sinn is sometimes too gloomy about the country's prospects. Not only does he overlook some of the genuine structural changes made in the past few years; but he also largely dismisses the lessons from Scandinavian countries that have managed to combine high taxes and generous welfare with rapid growth and high employment.

The book also betrays another German obsession: with the health of manufacturing industry. In fact, the continuing high share of manufacturing in German GDP, long a source of competitive strength, might now be a weakness. The forces of globalisation are driving even high-end manufacturing to lower-cost competitors in eastern Europe, China and India. As Britain found in the 1980s, most efforts to keep manufacturing jobs fail.

What is striking about Germany to an outsider is not its dynamism, export prowess or even the famous *Mittelstand* of small and medium-sized enterprises, impressive as these are. It is the absence of well-developed service industries. Part of the wrenching change the country now needs is to switch from low value-added manufacturing towards higher value-added services. And that needs a cultural as much as an economic shift, away from a macho world view that looks down on serving people. The transition could be painful but it must come.

Can Germany Be Saved?: The Malaise of the World's First Welfare State.
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Elizabeth Marsh

Rising out of obscurity

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THE daughter of a shipwright in the Royal Navy, Elizabeth Marsh had her first sailing adventure as she travelled in her mother's womb from Jamaica to England in 1735. During the next 50 years, she took off many times, sometimes impetuously, always for adventure beyond the bounds of conventional English life. She was not a patrician like some of the now-celebrated female travellers of the 18th century but an under-educated woman of tremendous guts who liked to be on the move in foreign cultures. From scant first-hand evidence, Linda Colley has mined the diaries of relatives to pull together a compelling portrait that sets her heroine against the rise of the British empire.

When she was 21, Elizabeth sailed to Menorca. Returning home, her ship was seized by Moroccan pirates and she was taken to the ruler of Morocco, Sidi Muhammad, who saw the pretty white woman as an addition to his harem. With help from Elizabeth's own account in “The Female Captive”, a book she wrote about her time at the Muslim court, Ms Colley builds a breathtaking tale of her escape, virtue intact. To win her release, Elizabeth feigned marriage and refused food and drink in case they were drugged. Taken by a female slave to see the sultan, seated under a canopy of crimson velvet, richly embellished with gold, she went down on her knees to implore him for compassion.

Having survived that ordeal, she promptly married her fiancé, James Crisp, a trader in luxury goods who sailed between Europe, Jamaica and Florida, then a Spanish holding. Briefly in the early 1760s the couple lived comfortably in London and had two children. When her husband went bankrupt and moved to India with the East India Company, she followed. She arrived in Madras in 1771 with her young daughter. She was far from the first British woman traveller in India but she was an early one: fewer than 100 European women and children lived there.

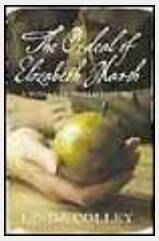
Apparently bored and approaching middle age, she took off for an 18-month sojourn in southern India with Captain George Smith, a dashing unmarried man she referred to as her cousin. Her diary jottings rejoice at the socialising: card parties and balls, the kind of frivolity that later became the focus of daily life for many colonial wives in India.

In 1783 she discovered she had breast cancer and two years later summoned the courage to have a mastectomy, without anaesthetic of course, in Calcutta. Her uncle wrote that she suffered “excruciating” pain and she died a few months after the operation.

A recurrent theme of Ms Colley's account is Elizabeth as a player in the increasingly globalised world of the 18th century. Attempts to understand or imagine her inner life tend to be a bit stilted, perhaps because the author is a historian, not a novelist. But this is a small cavil. By setting Elizabeth's tale in the context of British naval power and trade, Ms Colley allows the reader to vault the pioneering life of an obscure woman—not even an image survives—into a grander tale of physical hardiness and surprising moral choices.

The Ordeal of Elizabeth Marsh: A Woman in World History.
By Linda Colley.
Harper Press; 363 pages; £25.
To be published in America by Pantheon in September; $27.50

The Ordeal of Elizabeth Marsh: A Woman in World History
By Linda Colley



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Italy during the war

The cruellest years

Jul 12th 2007
From The Economist print edition

ERNEST RENAN, a 19th-century French philosopher, once famously observed that national identity requires a collective work of amnesia. In “The Fall of Mussolini”, Philip Morgan suggests that the Italians have more reasons than most to want to forget their modern history, especially the dog days of fascism. He provides a panoramic account of social and emotional life in 1940s Italy, with a stress on trauma, dislocation and brutishness.

The Fall of Mussolini
By Philip Morgan

Oxford University Press; 263 pages; $29.95 and £16.99

Buy it at
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Amazon.co.uk

By the end of the war mass political support for fascism had haemorrhaged. Diehards remained and some “ultras” longed for the apocalypse, or at least for taking the fight against the Allies to a redoubt in the Alps, there to die in a final courageous shoot-out. Many more experienced exhaustion, rage and despair. The once bombastic orator had himself lapsed into silence; in fact Benito Mussolini made only four public speeches during the entire course of the war.

Roger Viollet

Il Duce rescued by the Führer in 1943

Gaffes are rare in Mr Morgan's sober and balanced account, although a few slip through, such as the claim that myths (flat earth included, presumably) always have some basis in reality. In fact, much of the book is devoted to debunking Italian legend. Most of the people never became out-and-out partisans, but in large areas of the country there was ferocious strife, even tantamount to civil war. After Italy's armistice with the Allies in 1943, the invading German army was widely hated and sometimes severely undermined by opponents, communist or otherwise, although a number of fascist sympathisers bitterly complained about their country's disgraceful “betrayal” of the Führer.

Mr Morgan describes the Nazis' appalling crimes during their occupation of the peninsula and retreat north, but he is careful to present his history of Italian collusion, resistance and negotiation in a dozen shades of grey. Whether in the cities or the countryside, opinions and circumstances varied wildly. Desperate citizens, hunting food or patronage as the regime crumbled, often had to walk a dangerous path.

For many post-war families retrospection meant, at best, raw feeling and rancorous dispute, at worst, intolerable exposure to guilt. The author speculates as to whether there could have been an Italian version of the Nuremberg trials, and what difference it might have made. Instead, ad hoc settling of scores and summary executions of fascists were the order of the day after hostilities officially ended; the precise number who died in this way is disputed, but ran into thousands.

Many things set Mussolini apart from Hitler, not least the fact that he enjoyed a second coming. His first exit was in July 1943: a palace coup saw him arrested with surprisingly little fuss and spirited away in an ambulance. Even his closest associates believed that was the end of him. In fact, thanks to Hitler, he was brought back, but this time as a puppet.

The final curtain came in April 1945. He tried to slip the country but was hauled back by a partisan band. He, his mistress, Clara Petacci, and a couple of associates were executed before being left to swing

together, upside down, in a Milan square for the edification of the crowd. With commendable attention to detail, Mr Morgan points out how Petacci's skirt had been carefully secured to her body to avoid any semblance of impropriety.

The Fall of Mussolini.
By Philip Morgan.
Oxford University Press; 263 pages; $29.95 and £16.99

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Russia's art market

I'll buy it, especially if it's Russian

Jul 12th 2007
From The Economist print edition

The art scene in Russia is buzzing as local collectors snap up great works, particularly by their own countrymen

"FORGET the diamonds, buy me an art gallery." Do Moscow beauties really say this to their sugar daddies? Given the current mood in Russia's capital it is almost likely. At home, at the Venice Biennale and in the galleries and auction houses of London and New York, Muscovites are suffering from art mania, and loving it.

Winzavod, a vast former brewery in Moscow, is being turned into a complex of galleries, studios, performance spaces, bars and cafés. In May alone the city was host to Art Moscow, a contemporary art fair with more than 60 exhibitors. This was followed by the fourth Moscow World Fine Art Fair attended by 50,000 people; its 75 dealers included some of the biggest international names in fine art, antiques and jewellery. Two private museums opened the same week.

Understanding Russia's buzzing market is not easy for foreign dealers. Eager as they are to buy art, Russians exhibit a desire for discretion that borders on secretiveness. One reason may be VAT of 18% and a law that requires individuals to be named on receipts. This affects how people do business but it does not keep them from spending lavishly and without a trace of puritan guilt.

On the contrary. Spending is good in Moscow. Spending more is even better. Mercedes and Hummers (black with blackened windows) clog the streets. A quarter of the Russian population may be on the breadline but the rich and flashy shop with carryalls packed with rubles.

AP

Bringing the eggs home

Yet it is not money alone that drives this art market: national pride plays a big part. At London's Grosvenor House art fair in June, Russians enthusiastically bought Fabergé (three years ago, Viktor Vekselberg, an art-collecting industrialist, bought the Forbes Fabergé collection for a reputed $120m). Some 80% of buyers at London's and New York's specialist Russian auctions are from the former Soviet Union. Among the many Moscow collectors who are reconnecting themselves with their past are Iveta and Tamaz Manasherov, who are building an impressive collection of Russian 1960s artists.

For foreigners, a visit to the Tretyakov museum's 20th-century galleries, opened in 1998, offers a crash course in modern Russian art history. The display begins with works by artists such as Chagall, Kandinsky, Soutine and Goncharova. For the first two decades of the 20th century, the Russian avant-garde with its Rayonism, Constructivism and the Suprematists was a bold, inventive force in international art. Then came the 1930s, when everything except Socialist Realism was outlawed, filling rooms with portraits of Stalin and rosy-cheeked peasants. Russian art stagnated. The fate of many artists was worse.

Now Russians are racing to catch up on lost time. For socialites, celebrities and billionaires, Venice last month was the place to be, as the art world gathered for the preview of the current Biennale. It was, said Fedor Pavlov-Andreevich, the head of Marka:ff, a private foundation promoting Russian contemporary art, "a Russian Biennale". Many of the Russian visitors were so new to the scene that they did not know that the Biennale is an exhibition not a fair. But they learned fast enough that works can often be reserved for later purchase: three Tracey Emins were among the pieces snapped up by Janna Bullock, an American-Russian property tycoon.

At a party given in London by Christie's last month to preview its sale of Russian art, a Balalaika troupe

in native costume started to perform. The Russians present, perhaps feeling they were being patronised, drifted into another room, leaving others to clap. Whether they are buying work by their countrymen or by foreigners, Russians are ready to be an integral part of the international art world again. Ready? Determined is more like it.

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George Melly

Jul 12th 2007
From The Economist print edition

Alan George Heywood Melly, jazzman and writer, died on July 5th, aged 80

Camera Press

AMONG his many unguilty pleasures—Marlboro Lights, Irish whiskey, bacon and eggs, blue jokes, smoke-filled dives where the music wandered on till four in the morning, voracious sex with good-looking men and women—George Melly especially liked to fish. The man famous for red, green and cream striped suits, red fedoras and a huge, rude, laughing mouth could often be found quite still, thigh-deep in the Usk or the Teifi, preparing to cast as soon as a bold trout tickled the surface of the water. And the singer whose party piece, when touring with John Chilton and the Feetwarmers, was to scamper round the stage and groom the clarinettist's head during his rendition of “Organ Grinder Blues”, would admit that his thoughts on the river bank were of poppies, midges, Magritte and clouds.

And sex. This had been his driving force since his first schoolboy fumbles at Stowe, first rampantly homosexual, then generously heterosexual, among anchor chains and on Hampstead Heath, in the backs of vans and in glorious pulsating piles on the floors of stately homes. And there was, he confessed (being the most shockingly confessional of writers), sheer orgiastic pleasure in the tug of a bloody great fish, the line screaming off the reel, the catch leaping from the water in a shower of diamonds, the net sliding under it and the fish laid, beautifully marked, on the grass. Phew! Time for a ciggie.

But Mr Melly liked fishing for another reason. As a lifelong Surrealist, he was sure that the bizarre and marvellous lay in wait for him everywhere, and carried in his head a Surrealist motto, “the certainty of chance”. Chance might give him a fish with the next cast; and chance shaped his drifting, exuberant, deep-drinking life, from Stowe to the wartime navy to art-dealing to journalism on the *Observer*, through a rich cast of queens, hoodlums, sailors, old trouts, whores and martinets, until in 1974 the career of a risqué jazz singer finally hooked him for good.

He sang for 30 years, stoutly and louchely fronting the Feetwarmers at Ronnie Scott's and round the country, until he had to growl his Hoagy Carmichael numbers from a wheelchair. Mr Melly was possibly the most popular jazzman in Britain, and certainly the most outrageous.

Like all the addictions of his life, jazz burst on him at school. A friend's study; a gramophone; an old 78, and the voice of Bessie Smith, straight out of Harlem.

> Gimme a pigfoot and a bottle of beer
> Send me again. I don't care.

Mr Melly sang Bessie, “Empress of the Blues”, more than anyone else. He would entreat her to possess him before a performance. But the Bessie that emerged from that quivering, beer-wet throat was partly a

white, English, middle-class creature, drawn from music-hall turns and end-of-the-pier shows, dressed in bowlers and blazers, and with the plunk-plunk of a banjo never far away. Trad jazz, in the person of Mr Melly, Humphrey Lyttleton and a few others, limped through the 1960s and 1970s until out of sheer graft, longevity and good humour it came back into favour. He helped it survive.

Starfish in mousetrap

Classlessness and anarchism drew him to jazz also. Though his background was wealthy Liverpudlian, his inter-war fling with left-wing politics stayed with him for life. So, too, did other flirtations. On shore leave from the navy in “amusing” bell-bottoms in his roaring homosexual years, he admired a pimp encountered in Leeds in a mauve silk shirt and kipper tie, and the way Quentin Crisp's painted toenails accessorised his golden sandals. The gay fetishes faded, though as “an old tart” he could always have his head turned by pretty boys; but sharp tailoring in eye-watering colours became his stock in trade.

This aesthetic streak pointed to yet another side of his sprawling personality. He knew about art, and had an eye for it, ever since his inclusion as a wide-eyed *petit marin* in the Surrealist circle round E.L.T. Mesens in Soho in the 1950s. On impulse he made surreal objects himself (a dead starfish caught in a mousetrap, a nude with Carnation Milk tins as her breasts), but he also learned to buy cleverly in a difficult market. One train trip back to Liverpool from London was spent in silent adoration of two new acquisitions by Max Ernst, propped on the opposite seat.

As old age advanced, Surrealism became an increasing comfort to him. It gave an aesthetic purpose to his multicoloured lines of pills, and to the hours spent in limbo in the scanner. Deafness reminded him of Surrealist word-games in which question and answer were unrelated, or only incidentally and wonderfully so:

> What is reason?
> A cloud eaten by the moon.

Fishing, too, was still a comfort. He imagined his cancer—for which he refused all treatment so that he could go on performing—as a tiny fish dangling at the end of his lung, wrinkling its whiskers, ready perhaps to be caught. And he often said that his favourite end, other than collapsing in the wings of a theatre with wild applause still ringing in his ears, would be to be discovered smiling on a riverbank with a big beautifully marked trout beside him, death and sex together.

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Overview

Jul 12th 2007
From The Economist print edition

American companies, excluding farms, added 132,000 workers to their payrolls in June, in keeping with the average pace of hiring this year. The unemployment rate remained at 4.5%.

China's foreign-exchange reserves stood at $1.33 trillion at the end of June, according to its central bank. It accumulated $266.3 billion in the first half of 2007, more than in the whole of 2006.

In **Germany**, industrial production grew by 1.9% in May, leaving it 4.6% higher than a year earlier. This marked a recovery from poor figures in April.

In a speech to the European Parliament, Jean-Claude Trichet, president of the **European Central Bank** (ECB), struck a hawkish tone. He said the bank would take “firm and timely action” to counter a list of “upside risks” to inflation, including wage demands, indirect taxes and vigorous credit growth. He also said that monetary policy in the euro area remains “accommodative”.

Japanese consumers are struggling to maintain their high spirits of spring. The index of consumer confidence fell in June for the second month in a row.

The **Bank of Canada** raised its key interest rate by 0.25 percentage points to 4.5% and gave warning of further increases to come.

Scandinavian inflation is subdued. In **Sweden**, consumer prices rose by 1.9% in the year to June. In **Norway**, they rose by 0.4%.

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Output, prices and jobs

Jul 12th 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2007†	2008†	latest	latest	year ago	2007†	rate‡, %
United States	+1.9 Q1	+0.7	+2.1	+2.7	+1.6 May	+2.7 May	+4.2	+2.7	4.5 Jun
Japan	+2.6 Q1	+3.3	+2.6	+2.3	+3.7 May	nil May	+0.1	−0.1	3.8 May
China	+11.1 Q1	na	+10.3	+9.7	+18.1 May	+3.4 May	+1.4	+2.8	9.5 2006
Britain	+3.0 Q1	+2.8	+2.8	+2.4	+0.6 May	+2.5 May**	+2.2	+2.4	5.5 Apr††
Canada	+2.0 Q1	+3.7	+2.5	+2.7	−0.7 Apr	+2.2 May	+2.8	+2.3	6.1 Jun
Euro area	+3.0 Q1	+2.4	+2.7	+2.3	+2.8 Apr	+1.9 Jun	+2.5	+2.0	7.0 May
Austria	+3.5 Q1	+3.6	+2.9	+2.6	+9.1 Apr	+2.1 May	+1.7	+1.8	4.3 Jun
Belgium	+2.9 Q1	+2.9	+2.6	+2.3	+1.8 May	+1.3 Jun	+1.9	+1.8	10.5 Jun‡‡
France	+2.1 Q1	+2.4	+2.0	+2.1	−0.3 May	+1.1 May	+2.1	+1.5	8.1 May
Germany	+3.6 Q1	+2.1	+2.8	+2.3	+4.6 May	+1.8 Jun	+2.0	+1.9	9.1 Jun
Greece	+4.6 Q1	na	+3.7§	+3.2§	+0.2 Apr	+2.6 Jun	+3.2	+2.6§	9.5 Mar
Italy	+2.3 Q1	+1.1	+1.9	+1.7	+0.9 May	+1.6 May	+2.2	+1.8	6.2 Q1
Netherlands	+2.5 Q1	+3.6	+2.7	+2.6	+2.2 May	+1.7 Jun	+1.7	+1.8	4.6 May††
Spain	+4.1 Q1	+4.6	+3.7	+2.8	+2.4 May	+2.4 Jun	+3.9	+2.6	8.2 May
Czech Republic	+6.1 Q1	+6.1	+5.3	+4.9	+14.0 Apr	+2.5 Jun	+2.8	+2.6	6.4 May
Denmark	+2.3 Q1	+2.2	+2.2	+2.0	−4.3 May	+1.4 Jun	+2.1	+1.9	3.6 May
Hungary	+2.7 Q1	+2.4	+2.6	+3.1	+5.7 May	+8.6 Jun	+2.8	+6.8	7.3 May††
Norway	+2.8 Q1	+2.9	+2.7§	+2.5§	+6.1 Apr	+0.4 Jun	+2.1	+0.8§	2.7 May††
Poland	+7.4 Q1	na	+6.0	+5.3	+8.1 May	+2.3 May	+1.2	+2.2	13.0 May‡‡
Russia	+7.9 Q1	na	+6.7	+6.4	+6.7 May	+8.5 Jun	+9.1	+8.2	6.9 May‡‡
Sweden	+3.0 Q1	+2.6	+3.5	+3.2	+3.6 May	+1.9 Jun	+1.5	+1.8	3.9 May‡‡
Switzerland	+2.4 Q1	+3.2	+2.4	+2.1	+7.3 Q1	+0.5 May	+1.4	+0.7	2.5 Jun‡‡
Turkey	+6.8 Q1	na	+4.6	+5.7	+5.2 May	+8.6 Jun	+10.1	+8.3	11.4 Q1‡‡
Australia	+3.8 Q1	+6.6	+3.5	+3.3	+5.5 Q1	+2.4 Q1	+3.0	+2.3	4.3 Jun
Hong Kong	+5.6 Q1	+2.0	+5.3	+4.9	−1.5 Q1	+1.2 May	+2.1	+2.4	4.3 May††
India	+9.1 Q1	na	+8.1	+7.6	+12.4 Apr	+6.6 May	+6.3	+5.7	7.6 2006
Indonesia	+6.0 Q1	na	+6.0	+5.8	+8.3 Apr	+5.8 Jun	+15.5	+6.5	9.8 Feb
Malaysia	+5.3 Q1	na	+5.4	+5.6	+3.1 May	+1.4 May	+3.9	+2.3	3.4 Q1
Pakistan	+6.6 2006§§	na	+6.8§	+5.9§	+6.8 Sep	+7.0 Jun	+7.6	+6.3§	na
Singapore	+8.2 Q2	+12.8	+5.5	+5.7	+17.7 May	+1.0 May	+1.1	+1.6	2.9 Q1
South Korea	+4.0 Q1	+3.6	+4.3	+4.6	+6.6 May	+2.5 Jun	+2.4	+2.2	3.3 Jun
Taiwan	+4.2 Q1	na	+4.2	+4.6	+6.4 May	+0.1 Jun	+1.7	+1.3	4.0 May
Thailand	+4.3 Q1	+4.9	+4.0	+4.7	+6.3 May	+1.9 Jun	+5.9	+2.5	1.6 Mar
Argentina	+8.0 Q1	+4.1	+7.5	+5.7	+4.0 May	+8.8 Jun	+11.0	+9.8	9.7 Q1‡‡
Brazil	+4.3 Q1	+3.2	+3.9	+3.7	+4.9 May	+3.7 Jun	+4.0	+3.6	10.1 May‡‡
Chile	+5.8 Q1	na	+5.2	+5.1	+3.0 May	+3.2 Jun	+3.9	+2.6	6.7 May†††‡
Colombia	+8.1 Q1	nil	+5.4	+4.6	+13.3 Apr	+6.0 Jun	+3.9	+5.1	11.0 Apr‡‡
Mexico	+2.6 Q1	+0.6	+3.2	+3.8	+1.5 Apr	+4.0 Jun	+3.2	+3.8	3.2 May‡‡
Venezuela	+8.8 Q1	na	+6.6	+3.9	+6.7 Mar	+19.5 May	+10.4	+17.6	8.0 Q2‡‡
Egypt	+7.4 Q1	na	+6.3	+5.6	+10.5 2006	+8.5 Jun	+6.4	+9.9	9.0 Q4‡‡
Israel	+5.4 Q1	+6.3	+4.7	+4.3	+9.1 Apr	−1.3 May	+3.5	+0.9	7.7 Q1
Saudi Arabia	+4.3 2006§	na	+3.9§	+5.0§	na	+3.0 May	+2.2	+2.7§	na
South Africa	+5.4 Q1	+4.7	+4.8	+4.9	+3.8 Apr	+6.9 May	+3.9	+5.4	25.5 Sep‡‡
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	+9.8 Q1	+9.5	+9.4§	+5.8§	+6.2 May	+5.8 Jun	+4.3	+5.3§	4.7 Apr
Finland	+5.4 Q1	+3.4	+2.7§	+2.5§	−2.0 May	+2.4 May	+1.7	+1.4§	6.3 May
Iceland	−0.1 Q1	−3.6	+1.0§	+2.2§	+7.6 2006	+3.8 Jul	+8.4	+4.6§	1.1 May‡‡
Ireland	+7.5 Q1	+20.1	+5.0§	+3.4§	+5.8 Apr	+5.0 May	+3.9	+4.2§	4.6 Jun
Latvia	+10.7 Q1	na	+9.6§	+7.5§	−0.9 Apr	+8.8 Jun	+6.3	+7.6§	5.6 May
Lithuania	+8.3 Q1	+6.1	+7.0§	+6.4§	na	+4.8 Jun	+3.7	+2.2§	5.4 Apr
Luxembourg	+5.0 Q4	+7.0	+4.9§	+4.9§	+1.8 Mar	+1.9 May	+3.1	+2.2§	4.1 May‡‡
New Zealand	+2.7 Q1	+2.5	+2.8§	+3.1§	−0.4 Q4	+2.5 Q1	+3.3	+2.2§	3.8 Q1
Peru	+7.3 Apr	na	+6.7	+5.6	+10.8 Apr	+1.6 Jun	+1.8	+1.1	8.0 May‡‡
Philippines	+6.9 Q1	+10.3	+5.7	+5.8	−1.3 Apr	+2.3 Jun	+6.7	+3.9	7.4 Q2‡‡
Portugal	+2.1 Q1	+3.2	+1.8§	+2.1§	+3.8 Apr	+2.4 May	+3.8	+2.3	8.4 Q1‡‡
Slovakia	+9.0 Q1	na	+8.0§	+6.0§	+17.4 May	+2.5 Jun	+4.6	+2.5	10.5 Apr
Slovenia	+7.2 Q1	na	+4.6§	+4.1§	+2.5 May	+3.6 Jun	+2.9	+2.7	7.9 Apr‡‡

*% change on previous quarter, annual rate. †*The Economist* poll. ‡National definitions. §Economist Intelligence Unit estimate/forecast. **RPI inflation rate 4.3% in May. ††Latest three months. ‡‡Not seasonally adjusted. §§Year ending June.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Jul 12th 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Jul 3rd	Jul 10th*	% change on one month	% change on one year
Dollar index				
All items	202.3	205.2	+1.8	+13.4
Food	168.8	172.8	+2.0	+21.9
Industrials				
All	245.6	247.1	+1.6	+6.7
Nfa†	159.2	160.9	–1.1	+0.4
Metals	292.8	294.1	+2.4	+8.8
Sterling index				
All items	152.1	153.7	–0.7	+3.3
Euro index				
All items	137.4	138.2	–1.2	+5.4
Gold				
$ per oz	653.10	664.35	+2.5	+4.7
West Texas Intermediate				
$ per barrel	71.43	72.63	+11.2	–1.9

*Provisional †Non-food agriculturals.

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France

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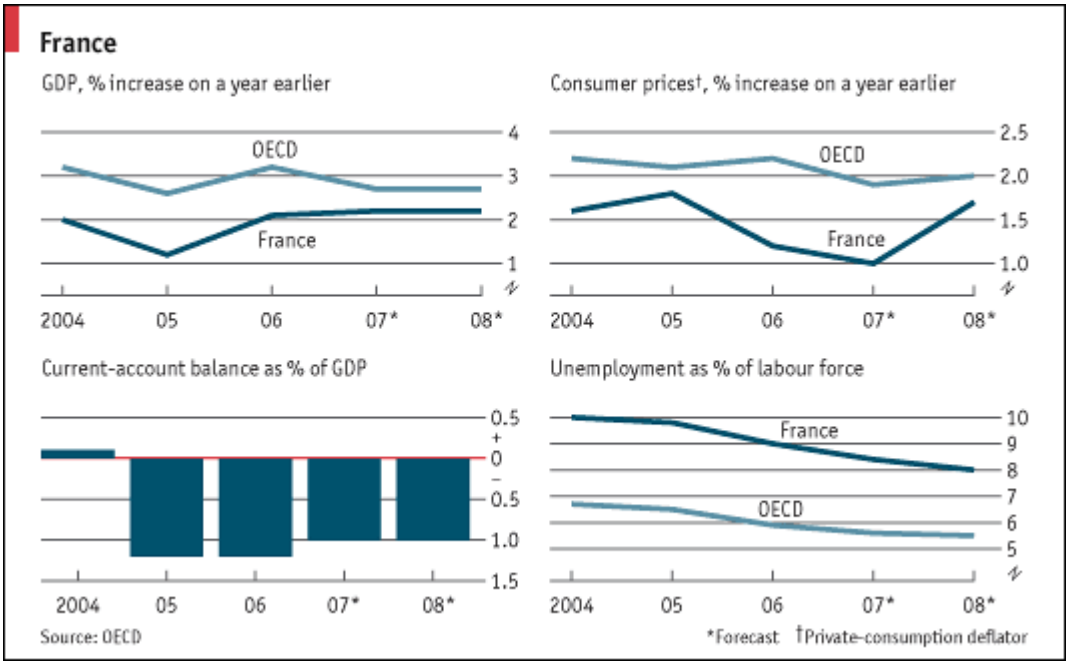
From The Economist print edition



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Trade, exchange rates, budget balances and interest rates

Jul 12th 2007
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†	Currency units, per $ Jul 11th	Currency units, per $ year ago	Budget balance % of GDP 2007‡	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−829.9 Apr	−803.4 Q1	−6.0	–	–	−1.4	5.19	5.07
Japan	+92.0 Apr	+190.0 May	+3.4	122	116	−4.4	0.65	1.87
China	+229.1 Jun	+249.9 2006	+8.1	7.56	7.99	−0.7	3.13	4.13
Britain	−155.2 May	−93.0 Q1	−3.2	0.49	0.55	−2.8	5.97	5.45
Canada	+46.0 Apr	+18.5 Q1	+1.6	1.06	1.14	0.9	4.50	4.61
Euro area	+8.6 Apr	+8.1 Apr	nil	0.73	0.79	−0.9	4.20	4.57
Austria	+0.7 Apr	+10.3 Q4	+2.9	0.73	0.79	−0.8	4.20	4.66
Belgium	+19.5 Apr	+11.2 Mar	+2.1	0.73	0.79	nil	4.26	4.66
France	−36.1 May	−32.3 Apr	−1.2	0.73	0.79	−2.8	4.20	4.64
Germany	+234.6 May	+175.4 May	+4.9	0.73	0.79	0.3	4.20	4.57
Greece	−46.6 Apr	−33.2 Apr	−8.4‡	0.73	0.79	−2.4	4.20	4.84
Italy	−22.4 Apr	−48.4 Apr	−2.0	0.73	0.79	−2.6	4.20	4.80
Netherlands	+43.7 Apr	+16.8 Q1	+7.8	0.73	0.79	0.6	4.20	4.62
Spain	−118.5 Apr	−113.0 Mar	−8.6	0.73	0.79	1.1	4.20	4.65
Czech Republic	+2.8 May	−5.7 Apr	−3.8	20.6	22.5	−4.0	3.00	4.59
Denmark	+5.4 May	+5.3 May	+2.3	5.40	5.88	4.0	4.41	4.62
Hungary	−0.4 May	−6.2 Q1	−4.7	179	218	−6.7	7.60	6.60
Norway	+54.1 May	+57.3 Q1	+14.3‡	5.78	6.27	16.8	4.88	5.10
Poland	−7.1 Apr	−8.8 Apr	−2.6	2.73	3.19	−2.3	4.78	5.63
Russia	+128.3 May	+87.4 Q1	+5.7	25.5	26.9	2.4	10.00	6.08
Sweden	+19.5 May	+29.8 Q1	+6.9	6.65	7.23	2.2	3.43	4.50
Switzerland	+10.5 May	+102.1 Q1	+14.4	1.20	1.24	0.3	2.71	3.24
Turkey	−53.4 May	−31.3 Apr	−7.0	1.29	1.56	−2.8	18.95	6.65§
Australia	−9.9 May	−43.8 Q1	−5.4	1.16	1.33	1.3	6.44	6.15
Hong Kong	−18.9 May	+23.2 Q1	+9.8	7.82	7.78	2.7	4.42	4.57
India	−63.2 May	−9.6 Q1	−1.8	40.4	46.3	−3.3	7.37	8.22
Indonesia	+41.4 May	+10.3 Q1	+2.2	9,033	9,110	−1.6	8.28	6.76§
Malaysia	+28.5 May	+26.0 Q1	+13.5	3.45	3.66	−3.4	3.62	5.59§
Pakistan	−13.6 May	−6.8 Q1	−5.7‡	60.4	60.2	−3.8	9.55	7.39§
Singapore	+35.4 May	+38.1 Q1	+23.3	1.52	1.59	0.3	2.50	2.87
South Korea	+18.7 Jun	+4.6 May	+0.2	919	949	0.5	5.01	5.38
Taiwan	+13.8 Jun	+28.1 Q1	+6.7	32.7	32.5	−2.2	2.55	2.64
Thailand	+7.7 May	+9.6 May	+2.1	33.3	37.9	−1.9	3.75	4.27
Argentina	+11.3 May	+7.8 Q1	+2.5	3.10	3.08	1.2	9.38	na
Brazil	+47.4 Jun	+14.9 May	+0.8	1.89	2.19	−2.4	11.93	6.16§
Chile	+25.5 Jun	+7.1 Q1	+1.3	518	540	5.5	5.40	5.68§
Colombia	−0.9 Apr	−4.1 Q1	−2.7	1,966	2,511	−0.9	8.16	6.20§
Mexico	−11.3 May	−5.5 Q1	−1.4	10.8	11.0	−0.2	7.18	7.71
Venezuela	+28.2 Q1	+23.8 Q1	+9.8	2,147	2,646	−4.1	10.14	6.55§
Egypt	−14.1 Q1	+3.3 Q1	+1.5	5.69	5.75	−5.5	6.80	5.62§
Israel	−7.5 May	+8.1 Q1	+3.6	4.25	4.44	−0.8	3.72	5.03
Saudi Arabia	+148.5 2006	+95.4 2006	+21.4‡	3.75	3.75	16.6	5.04	na
South Africa	−9.2 May	−16.6 Q1	−6.0	7.03	7.13	0.5	9.70	8.40
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−3.9 Apr	−3.1 Apr	−14.9‡	11.4	12.3	2.7	4.72	na
Finland	+12.3 Apr	+13.9 Apr	+5.7‡	0.73	0.79	2.5	4.15	4.64
Iceland	−1.9 May	−4.0 Q1	−17.4‡	60.3	74.2	2.8	13.85	na
Ireland	+35.2 Apr	−10.6 Q1	−5.0‡	0.73	0.79	0.5	4.20	4.64
Latvia	−5.8 Apr	−5.4 Apr	−20.0‡	0.51	0.55	nil	6.15	na
Lithuania	−6.3 May	−3.7 Apr	−10.3‡	2.51	2.72	−0.5	4.95	na
Luxembourg	−5.3 Apr	+4.5 Q1	na	0.73	0.79	0.3	4.20	na
New Zealand	−3.9 May	−9.1 Q1	−10.2‡	1.28	1.63	3.2	7.05	6.73
Peru	+9.0 Apr	+2.7 Q1	+1.8	3.16	3.24	0.4	4.75	na
Philippines	−3.7 Apr	+5.7 Mar	+3.6	46.3	52.2	−0.7	6.56	na
Portugal	−23.0 Apr	−17.8 Mar	−7.9‡	0.73	0.79	−3.3	4.20	4.77
Slovakia	−2.0 May	−3.8 Mar	−4.3‡	24.2	30.3	−2.9	4.10	4.64
Slovenia	−2.3 May	−1.5 Apr	−2.0‡	0.73	0.79	−1.2	na	na

*Merchandise trade only. †*The Economist* poll. ‡Economist Intelligence Unit forecast. §Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Jul 12th 2007
From The Economist print edition

Markets

	Index Jul 11th	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	13,577.9‡	nil	+8.9	+8.9
United States (S&P 500)	1,518.8‡	−0.4	+7.1	+7.1
United States (NAScomp)	2,651.8‡	+0.3	+9.8	+9.8
Japan (Nikkei 225)	18,049.5	−0.7	+4.8	+2.5
Japan (Topix)	1,767.7	−0.8	+5.2	+2.8
China (SSEA)	4,057.0	+1.3	+44.1	+48.7
China (SSEB, $ terms)	259.6	+1.9	+93.3	+99.5
Britain (FTSE 100)	6,615.1	−0.9	+6.3	+10.5
Canada (S&P TSX)	14,166.1	+0.8	+9.7	+20.8
Euro area (FTSE Euro 100)	1,399.0	−1.6	+9.4	+14.3
Euro area (DJ STOXX 50)	4,447.5	−1.7	+8.0	+12.8
Austria (ATX)	4,868.1	−1.3	+9.1	+13.9
Belgium (Bel 20)	4,590.2	−1.5	+4.6	+9.3
France (CAC 40)	6,001.1	−1.6	+8.3	+13.1
Germany (DAX)*	7,898.5	−2.2	+19.7	+25.1
Greece (Athex Comp)	4,964.0	+0.8	+13.0	+18.0
Italy (S&P/MIB)	41,795.0	−1.4	+0.9	+5.4
Netherlands (AEX)	553.6	−0.1	+11.8	+16.7
Spain (Madrid SE)	1,626.5	−1.6	+4.6	+9.3
Czech Republic (PX)	1,863.2	−1.8	+17.3	+19.0
Denmark (OMXCB)	481.5	+0.5	+13.5	+18.8
Hungary (BUX)	28,831.4	−2.0	+16.0	+23.5
Norway (OSEAX)	591.6	−0.4	+17.7	+26.8
Poland (WIG)	65,815.1	−1.7	+30.6	+38.6
Russia (RTS, $ terms)	1,995.6	+2.7	+0.6	+3.8
Sweden (Aff.Gen)	409.5	+0.4	+12.1	+15.3
Switzerland (SMI)	9,214.4	−0.9	+4.9	+6.6
Turkey (ISE)	50,055.5	+1.2	+28.0	+40.5
Australia (All Ord.)	6,363.2	+0.5	+12.7	+23.3
Hong Kong (Hang Seng)	22,607.0	+1.7	+13.2	+12.7
India (BSE)	14,910.6	+0.2	+8.2	+18.5
Indonesia (JSX)	2,273.4	+3.5	+25.9	+25.4
Malaysia (KLSE)	1,359.3	−1.3	+24.0	+26.7
Pakistan (KSE)	13,967.4	+0.7	+39.1	+40.3
Singapore (STI)	3,594.9	+1.1	+20.4	+21.9
South Korea (KOSPI)	1,890.0	+2.8	+31.8	+33.3
Taiwan (TWI)	9,291.0	+2.4	+18.8	+18.2
Thailand (SET)	846.3	+2.5	+24.5	+35.0
Argentina (MERV)	2,266.1	+0.6	+8.4	+7.2
Brazil (BVSP)	56,356.0	+1.2	+26.7	+42.8
Chile (IGPA)	14,878.1	−1.9	+20.2	+23.5
Colombia (IGBC)	10,805.2	+1.4	−3.2	+10.3
Mexico (IPC)	31,916.3	−0.9	+20.7	+20.7
Venezuela (IBC)	40,952.8	+2.2	−21.6	+22.1
Egypt (Hermes)	73,791.4	+1.9	+20.4	+20.8
Israel (TA-100)	1,132.4	−0.2	+22.9	+21.8
Saudi Arabia (Tadawul)	7,451.4	+3.9	−6.1	−6.1
South Africa (JSE AS)	29,643.4	+2.8	+19.0	+19.2
Europe (FTSEurofirst 300)	1,601.2	−1.2	+7.9	+12.8
World, dev'd (MSCI)	1,625.1	−0.1	+9.5	+9.5
Emerging markets (MSCI)	1,113.8	+1.7	+22.0	+22.0
World, all (MSCI)	406.8	nil	+10.6	+10.6
World bonds (Citigroup)	664.7	+0.8	+1.0	+1.0
EMBI+ (JPMorgan)	411.1	−0.2	+0.9	+0.9
Hedge funds (HFRX)	1,371.4	+0.4	+7.5	+7.5
Volatility, US (VIX)	16.6	14.9	11.6	(levels)
CDSs, Eur (iTRAXX)†	32.5	+30.6	+39.4	+45.6
CDSs, N Am (CDX)†	48.0	+13.1	+43.5	+43.5
Carbon trading (EU ETS) €	0.09	−10.0	−98.6	−98.5

*Total return index. †Credit-default swap spreads, basis points. ‡Jul 3rd
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

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The world's biggest banks

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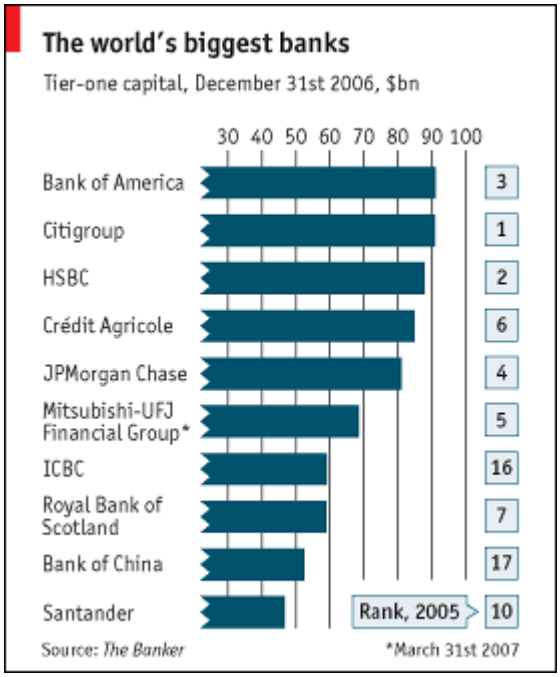

Bank of America was the biggest bank in the world last year, according to *The Banker* magazine, which ranked the top 1,000 banks on the basis of their holdings of tier-one capital. This is a bank's core reserve capital, comprising equity, disclosed reserves and retained earnings. Banks from emerging markets, including Brazil, India and Russia, prospered. Two Chinese banks (ICBC and Bank of China) made the top ten list for the first time. China also produced the highest number of new arrivals in the top 1,000 (seven). UBS was the biggest bank if total assets are taken as the measure, and Wintrust Financial earned the highest return on capital last year. But neither made the top ten for the tier-one list.

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